

PUBLIC ASPECTS OF FINANCE

BY

D. H. MACGREGOR

PROFESSOR OF POLITICAL ECONOMY
IN THE UNIVERSITY OF OXFORD

OXFORD

AT THE CLARENDON PRESS

1939

OXFORD UNIVERSITY PRESS
AMEN HOUSE, E.C. 4
London Edinburgh Glasgow New York
Toronto Melbourne Capetown Bombay
Calcutta Madras
HUMPHREY MILFORD
PUBLISHER TO THE UNIVERSITY

PRINTED IN GREAT BRITAIN

FOREWORD

THESE lectures were delivered at the London School of Economics in 1937, and have been revised and extended for publication. They deal with only certain aspects of public finance, to which, although they involve questions of principle, more attention has hitherto been given in public than in academic discussion.

CONTENTS

I. Expenditure and Policy .	7
II. Fructification and Reserve .	67

I

EXPENDITURE AND POLICY

THESE lectures deal with some questions of public finance from what may be called the public side. The ideas which are to be discussed have been contributed mainly by the financial discussions in Parliament during the last hundred years. The study might therefore be said to be one of cancellarian finance. But my purpose has not been merely historical; I have, rather, used an important historical period in order to relate, by critical explanation, the practice of public finance to its theory. More especially, there are some ideas which have not been so prominent in the academic treatment as they have been in the history of the subject, and whose significance is realized only when we observe how they have been conditioned and applied.

I should not apologize for recalling what great financiers have said many years ago, and I suppose there are some now who would be glad to think that what they said in 1937 will be still worth quoting a generation hence. The desire has greatly increased in our time to bring pure students of economic forces and tendencies into closer relation with the actual

EXPENDITURE AND POLICY

administration of affairs. In the sphere of public finance this connexion cannot be made in quite the same way as when we draw on the experience of leaders of business or of banking policy. Parliaments and Ministers change more quickly and are not chosen on the same ground of technical experience. But the constitution of a Parliament has usually been such that, in a set debate on a large issue of policy, there is very little that is left unsaid, and questions of theory and principle are greatly enriched by being set in this framework of diversified experience and judgement. I do not say this off-hand, but with memory of many classical debates. The origin of these lectures was, that I had to look up a reference in Hansard, a dangerous thing to do with that fascinating periodical, and did not end till I had read a whole century of financial debates, in order to perceive the evolution of ideas whose bare mention in the theory did not show their full content and significance. It is with this empirical 'correction' of these ideas that these lectures mainly deal.

I do not speak as an economic historian and have used a period of history only in the illustrative way. I might have thought that the maxim that 'expenditure depends on policy' was a mere truism, but the conflict between the forces of retrenchment and those of expansionist finance showed that it contained more than that. There have been many even in recent

EXPENDITURE AND POLICY

years who have wished us to believe that policy should depend on expenditure. Again, the pure theory of the marginal equivalence of expenditures is not the whole story, if that theory is to apply to the essential conditions of democratic parliamentary government. Or again, the questions of emergency finance, deficiency finance, and the 'reserve' of taxable capacity have been far more completely argued in public than in academic discussion. Or lastly, the influence of events and opinions upon each other has been shown in the two great reversals of fiscal policy, and in the history of graduated taxation.

Professor Einaudi has argued strongly against confusing public finance with 'a mixture of abstract reasoning and concrete discussion, theoretical schemes and historical examples, deductive reasoning and empirical illustration', and warns us against 'expecting inspiration from politicians', or from the 'various changeable, vague, and contradictory reasons which inspire the actions of politicians from time to time'.¹ I quote this only to show that I am aware of this objection, and have considered it.

If these lectures come somewhere between economics and politics, it is where they were meant to come. In a School devoted to both these studies it cannot be inappropriate to take this middle ground between complementary points of view.

¹ Introduction to de Viti de Marco's *Public Finance*.

British Public Finance

From about 1840 until the reversal in 1932 of the basis of our financial policy, was the period of what may be specially described as British public finance. The distinction of its leaders, and many of their expositions, and the success with which its principles carried the increasing burdens of military and social policy for nearly a century, have made it a classical period. The expectations on which it was founded, as regards its influence on the policy of other countries, were not fulfilled, but for nearly a century its principles were not reversed. They were at one time described as 'insular free trade', but the insularity was a fundamental aspect of our material resources in relation to employment. All the Chancellors since the time of Peel may be said to have belonged, until 1932, to the same school, in the sense that they had to work within the assumptions of the Peel-Gladstone finance. In later years the attendance of some of them at that school was compulsory rather than voluntary, and they had to observe the conditions imposed by the defeats of 'fair trade' proposals. 'Financially speaking,' says Dr. Clapham, 'Gladstone had generally been in power up to 1886'; and, in one large aspect, his influence persisted for nearly fifty years after that, a period which included the greatest impact of social and military events. The

principles had more to do with employment than with cheapness.¹ The Protectionist opposition was a different *analysis* of the methods of finance in their relation to employment.

Both Peel and Gladstone were given the credit or responsibility for ideas which they did not originate. Parnell and Cobden were the real authors. Disraeli was able to accuse Peel of being the plagiarist of other people's ideas, and any one who reads Cobden's pamphlets can see where some of Gladstone's employment theories came from. The transition can also be seen in such Budgets as Althorp's in 1831, which Morley calls 'the boldest since Pitt', with its classification of taxes on lines adopted later. There was the continuity of opinion influencing law, until the law made the opinion a public standard. It required, as happens in public affairs, the appeal and challenge that 'the time has come' to recognize a new condition, and this was dramatically forthcoming in the highest place.

It is notable how the influence of a growing opinion upon the law has depended sometimes for its final impact on two factors of human progress, emergency and personality. It was through emergency that the principles of the classical finance came to be established and, ninety years later, overthrown. In each case the advocates of the new outlook disentangled

¹ v. p. 46.

themselves and their case from the emergency itself, and sought to show that the remedies had independent and permanent validity. 'The stars in their courses fought for us, when so often they had fought against us', a statement of 1932, might have been made also in 1842. It takes nothing away from the acceptance of a new practice or theory, if it is the result of crisis, which is often the bridge between growing opinion and dogmatic practice. The debates of 1842-6 and 1932 are not dissimilar in their significance, and recall each other in many great passages. We are still too near to 1932 to speak in the same way of personality; no one can doubt what it meant to the foundation of the classical era of our finance.

One of the features of British finance in this period was the influence of its substance upon its methods of statement. The liberation from restrictive trade policy which the income tax made possible, and which made the revenue increase by the leaps and bounds which so delighted Gladstone, seemed to communicate itself to the spirit of financial exposition, so that the Budget became no mere statement of accounts, but was presented with a wealth of judgement, reflection, and imagination, which gave it, especially in certain series both before and after the War, an indisputable place in the political economy of finance. This function of educative exposition

had begun to appear in the statements of Goulburn in 1829 and Althorp in 1831; but Peel and Gladstone established it, when they had a theme to revel in and a principle to elaborate. In more recent times this half-theoretical and half-practical exposition of large issues has been borrowed in their own annual statements by the chairmen of banks, railways, and great concerns. In emulation of its first masters the tradition developed, and we can see how great Chancellors could live up to it while lesser ones, like Lowe, could not. In this manner, despite party changes and a growing strain on the basis of the principle towards the end of the nineteenth century, British finance was bodied forth to the world as a fundamental aspect of the liberal plan of capitalist democracy.

There were Chancellors and Chancellors. Peel, if he may be reckoned among them, was the great debater. Gladstone was said to talk shop like a tenth Muse. He had to listen to Lowe. Disraeli was not, I think, a great contributor, though he happened to be the author of some striking phrases which became current coin. He was a great pricker of bubbles. Northcote deflated ideas into his statements of common sense. Though expert finance came to the Treasury with Goschen, he was the first Chancellor to appreciate the expansive duty of the State in relation to expenditure. Hence the controversies between him and Harcourt, the disciple whom Gladstone

EXPENDITURE AND POLICY

loved, the last stalwart of retrenchment. Lloyd George broke the chains, not of old principles, for he was among the Gladstonians, but of the limited range and technique by which the instrument of taxation had been restricted. After the War there was more business in the financial statements as a whole: but what Dickens said Micawber had, 'the old roll in his voice', was restored to the Budget in the Churchill series, which recalls the tone and spirit of earlier days.

Laissez-faire

When the basis of our financial policy was changed in 1932, it was argued that we were at last free from the deadening influence of an outworn creed and were again masters of our own destiny. As in 1842, it was financial emergency which led to reconsideration and reversal of the existing basis of finance, and at both dates it was therefore possible to argue that fundamental interests were being sacrificed to short-period necessities, agriculture in the one case and trade in the other. But the difference between them was not one between *laissez-faire* and a financial plan.

In the debates on the tariffs in Peel's time it is plain that the decisions were come to for reasons that did not owe their origin simply to a system of ideas. For example, the debate on the Corn Laws occupies, from first to last, about 1,500 double-column pages

of Hansard, but I have not found in it a single mention of *laissez-faire*. No speaker of any importance even hinted at this argument. The discussion is concerned throughout with substantial issues of fact, and especially with the question whether wages vary with the price of food. Nor did Peel in 1842 put forward any dogma; he was practically faced with deficits and the inelasticity of the revenue under the existing system. He claimed that he had never gone a step beyond his own convictions, which had begun to change before he had read a word of the Report on Import Duties of 1840, which Disraeli was to describe later as 'one of the greatest works of imagination of the nineteenth century'. In his *Memoir* he stated the grounds of his conversion in 1846 as having been: conflict of argument on the principles of a restrictive policy; many converging proofs that wages do not vary with the price of food; comparative observation of public welfare in periods of dearth and abundance; and the conviction that the case for the Corn Laws had been weakened by the repeal of other duties. And he said in the House that

'we take into account vested interests, engaged capital, the importance of independent supply, the social benefits of flourishing agriculture. We find the general welfare will be best served by a fair adjustment, by allowing the legitimate logical deductions to be controlled by the thousand considerations which enter into moral and political questions, and

EXPENDITURE AND POLICY

which put a limit to the practical application of abstract reasoning.'

There was a considerable deference shown on both sides of the House over a long period to 'good political economy', but this phrase was not always used in the sense of an academic study. The references to Adam Smith came to little more than such references come to at any time; academic writers are quoted in support of the policies which agree with the trend of their teaching, and what else is to be expected? In the Corn Law debate of 1839 Peel had ridiculed certain disagreements of the English economists, from whom he said he could get no help; and on the Factory Bill of 1847 he had contrasted their views with what he thought were the more broadly based principles of the Italian economists, who 'regard political economy as a complex and comprehensive science which concerns, not only the wealth, but the morality and social welfare of the people'. At a later date Mr. Gladstone is supposed to have 'sent political economy to Saturn', but this appears to be a misquotation.¹ In my view, the economists derived more authority from, than

¹ He said, on the Irish Land Bill of 1881, that 'one member of the minority, Mr. Bonamy Price, is the only man, and to his credit be it said, who has had the resolution to apply, in all their unmitigated authority, the principles of abstract political economy to the people and circumstances of Ireland, exactly as if he were proposing to legislate for the inhabitants of Saturn or Jupiter'.

LAISSEZ-FAIRE

they gave to, the course of policy. The success of the new financial policy was in general accordance with the four synoptic gospels of Smith, Ricardo, McCulloch, and Mill. But a study of the debates will show that from 1842 to 1860 the same claim could be made as was made in 1932, and was made for Cobden, that 'the whole scheme rested on the wide positive basis of a great social expediency'.¹

Nothing is more evident than that the new British financial system was of the nature of a plan. It involved a deliberate review of the existing conditions, as far removed as could be from action on a mere idea. Peel brought, as his speeches show beyond argument, a plan and a purpose into an administration that was drifting and makeshift. It is not true that planning must always imply, far less be defined by, an increased degree of interference or restriction. In one of the several senses of the phrase, the trouble which Peel had to face was a *laissez-faire* Protectionism. In another sense, he did not 'leave the trader alone'; he made him pay an income tax which, unlike the tariff, he could not transfer to his customers.

The social policy which was at the same period represented by the Factory Acts, and which was further developed within the new system of finance, is a sufficient reply to the charge of the dogmatism

¹ Morley, *Life of Cobden*, vol. i, p. 97.

EXPENDITURE AND POLICY

of the time. There was much more argument on principles here than in reference to Free Trade. But it all came to little more than that reasons are required for imposing new conditions, and the reasons had to be stronger when the conditions imposed were restrictive than when they were liberating. There were extremists like Hume and Graham, but what was accepted was simply stated by Russell: 'Whenever you can interfere beneficially, there you ought to interfere; when it does not do good, there you ought to stop.'

'I admit', said Peel on the Factory Bill of 1844, 'that the principles of legislation are to be determined, not by any intuitive sense, but by the observation of facts, and from the conclusions of wisdom drawn from long experience. When we say that any enactment is conformable with principle, all I think we mean is, that our general experience tells us it is a rule to which in general legislation ought to conform, and the question always is in that case, will the practical good from any particular enactment counterbalance the evil of that enactment.'

And so, Lord Howick, in referring to Adam Smith in the same debate:

'What is meant by a general principle? I understand by a general principle some rule drawn from long experience and careful observation of facts, which sound legislation ought to follow; and if it is proved that what I have been accustomed to regard as a general principle does not hold

LAISSEZ-FAIRE

true in some particular instance, or that at all events there must be some mistake in the manner of stating it, and that it requires some limitation or qualification which had not been properly attended to, it is for the good of the community that it should be departed from.'

A fiercer controversy took place later on the Irish Land Bill, when Mill poured scorn on Lowe's interpretation of political economy, whose 'worst enemies were some of its friends'. But such restrictive legislation was enacted; and it is absurd to mark as the 'era of *laissez-faire*' either the whole period or its inception, resting the argument on the fact that, while Free Trade was carried, the Factory and other Acts were opposed, since an opposite view could be argued on the ground that the social legislation was carried while Free Trade was opposed. Indeed, in the debate of 1932 the Chancellor, in reintroducing Protection, argued that the Trade Union Acts (and, by implication, similar social legislation) were protectionist in their nature.

The use of the phrase *laissez-faire* has been largely a banality of discussion. There was no handy expression which, especially with the affectation of a foreign tongue, could express the simple fact that a piece of principled empirical legislation was of the nature of a removal of restrictions. The foolishness of the attempt to fasten this idea on the whole of an era of great social progress is shown in the orbital

EXPENDITURE AND POLICY

frequency with which a comet known as the 'end of *laissez-faire*' revisits our arguments. Cairnes observed it in 1870. The 'unauthorized' social programme of the eighties came forward as that form of the end of this idea which was called its 'death-knell'. At the same time Goschen published his address on its decline and fall. But Goschen remained a free-trader, and Chamberlain went out at the same time against 'fair trade', and ran the free-trade flag to his masthead. After the War the phenomenon was distinctly observed by Mr. Keynes.¹ In 1932 it was seen by many thousands at once. What does this mean, except that legislation should be in some cases restrictive and in others liberating? Neither of the French authors of the phrase, Boisguillebert and Gournay, was what we would call a free-trader, and repatriation would be a proper fate for an expression which has notably confused thought. All legislation has some date, and there must be a debate on whether it is to be enacted or not, and those who oppose it defend the existing condition; but the nature of an era is to be judged by what it enacts, and we cannot ascribe Free Trade to the dominance of a mere general idea in an era in which it was one of the exceptions to the trend of legislation.

¹ Cairnes, *Essays*, 1870; Goschen, *Laissez-faire*, 1870; Keynes, *The End of Laissez-faire*, 1926.

Expenditure and Policy

The first of the special principles which were discussed in cancellarian finance was the doctrine that 'expenditure depends on policy'. It would not have been possible to bring such a maxim into public discussion, both before and after the War, if it had been a mere truism. If the government as a whole should be rationed, as was suggested by politicians in the days of retrenchment, or the departments rationed, as has been suggested later, policy was being made to depend on expenditure. If a Chancellor like Harcourt could object to any 'fatalistic doctrine of progressive expenditure' in a growing nation, or Gladstone could make it one of the right rules of finance that governments 'should reduce their expenditure', these were protests against the doctrine of policy. Democratic finance meant in one sense the victory of this doctrine, in another sense the evolution of its meaning. What is called expansionist finance is the last stage of this evolution, because its idea that public spending may create the incomes which enable it to be carried on is the opposite pole to the idea that public expenditure should be so restricted that existing incomes should be left with a sufficient margin for *existing* needs.

Apart from the annual debates on the Budget, the House of Commons had a series of discussions on

such subjects as the 'State of the Nation' or the 'National Expenditure'. From the course of these debates we may take the following typical statements:

'This great, rapid, and menacing expenditure. If those in office do not mend their ways, a financial crisis will take place in this House, which will render it impossible for the public business to be carried on.' (Gladstone, 1868.)

'There are three principles on which all good finance should be based. The first is, that there should always be a certainty that, whatever the charge may be, it can be paid. The second is, that in time of peace and prosperity the country should reduce their debt; and the third is, *that they should reduce their expenditure.*' (Gladstone, 1882.)

'It is no longer our revenue but our expenditure which grows by leaps and bounds. In my opinion, we are living too fast. The English are not naturally thrifty. I entreat the Committee to resist the perpetual demands that are being made from every quarter for further expenditure.' (Harcourt, 1886.)

'There was once in this country an economical party. The Prime Minister and myself are the last survivors of that vanished creed. Financial economy has gone the way of political economy.' 'In private establishments, you regulate your outlay with some regard to your income, but in the public administration you have to make your taxes keep pace with your profusion.' (Harcourt, 1893, 1895.)

'The burdens of the taxpayer will become so great that

EXPENDITURE AND POLICY

there will be a reaction which will not only sweep away all who are responsible for it, but will do very much more.' (Hicks Beach, 1904.)

'The figures make a return to more thrifty and economical expenditure the first and paramount duty of the government.' (Asquith, 1906.)

On the other side:

'Mere abstract and declaratory opinions in favour of reduction and retrenchment are of no use whatever. I have so often maintained it in this House that I am almost ashamed to repeat it, but unfortunately it is not a principle which has yet sufficiently entered into public opinion—expenditure depends on policy.' (Disraeli, 1862.)

'The question which really rules finance, namely, the policy of which these figures are only the symbols. Finance is the handmaid of public policy.' (Lowe, 1871.)

'We know that it has been said, and extremely well said, that expenditure depends upon policy. I hope that we shall not invert the sentiment and say that our policy ought to be determined by the expenditure which we make.' (Northcote, 1879.)

'It was no use having an enquiry into expenditure. It was a matter of policy.' (Haldane, 1904.)

'No one need be afraid of any taxes being taken off in my time.' (Lloyd George, 1908.)

Such quotations could be multiplied manifold. The opposition of ideas continued after the War. In 1927 Mr. Asquith, endorsing the recommendation

EXPENDITURE AND POLICY

of the Committee of 1922 on National Expenditure, held that:

‘The only effective way of dealing with economy under existing conditions is that the Chancellor should ration all the Departments. It must be done all round.’

The answer of Sir Robert Horne was that:

‘When we come down to bedrock, the cause which is chiefly responsible is the policy of the government. It is policy upon which expenditure is founded.’

Principles of Expenditure

The doctrine of policy may be considered first in its relation to the principles of expenditure, which it serves both to illustrate and to qualify. All expenditure involves two ideas, the use of money, and the distribution of outlay between different purposes. The use of money means the choice of the range of expenditure, and a good use of money means that this range has not been narrowed by convention, or oversight, or any kind of prejudice. It may be narrowed by a general prejudice against expenditure, of which the doctrine of retrenchment was an instance. In private affairs a proper variety of expenditure increases the marginal value of money. In democratic public finance the competition between the interests of different political parties helps to prevent a conventional limitation of the range of expenditure. There must, for the best use of money,

be a due consideration and review of the things on which expenditure is possible. When the use of money has thus been determined, its distribution between the different purposes that are accepted as proper has to be made on the principle that the last or marginal unit of expenditure on each purpose gives what may be provisionally called an equal return. There is a rule, and a method. But the method, that is, equimarginal returns, only works completely to satisfy the rule, if all the applications of expenditure have been adequately considered. In other words, every economy is an administration of limited resources, and this administration is subject to the two defects of waste and parsimony. There may be parsimony of the objects of expenditure as a whole, or of one object as against another; while waste means either disregard of the minimum amounts of expenditure which make particular objects of expenditure effective, so that the range is too wide, or that the returns on effective expenditure are not equivalent at the margins of outlay.

✓ If there is a proper use of money, or range of considered expenditure, the fundamental principle is the equivalence of final expenditures on each purpose. The equivalence is in the returns on the outlay. There are two degrees in the estimation of these returns. The estimate may, in one aspect, be in respect of the improvement of the income which

EXPENDITURE AND POLICY

directly results, in each particular sphere, from its own expenditure as compared with that in another sphere. Thus we may say that the last public expenditure on defence causes us to be as much better defended as the last expenditure of the same amount on education causes us to be better educated as a nation. We make, so to speak, the blue as much bluer as the red is made redder. But this is an imperfect degree of equivalence of expenditures. The last expenditure on defence may have effects on the efficiency of education, or *vice versâ*; and the real equivalence is in terms of the whole income of the nation, when all the effects of every particular expenditure have been considered. The former or less perfect form of the estimate may often, however, be the more practicable in use. In public finance especially, it is often the point of the argument that, by some adjustment of taxation and expenditure, we have dealt fairly between different classes of the people, or have not starved one service *in relation to* another. This assumption, that the main effect of an extra outlay is to be judged by its special purpose, implies that the general system is already well arranged.

✓ The next question is how, on either standard, judgements of equivalence in results are possible. We do, and must, make such judgements. They are always judgements of comparison, involving the use of

PRINCIPLES OF EXPENDITURE

'more or less'. But this does not allow us to assume that they are judgements of quantity, for not all comparisons are quantitative. Kant answered a similar question, how certain judgements were possible, by indicating certain faculties of the mind. A fuller answer to the economic question will be found in the comparison which follows of different kinds of economy, public, private, and commercial. Meantime, we have to observe that the returns on expenditure are very different in kind, since some outlay is made in order to increase the personal satisfactions of individuals or classes, and some to improve the objective conditions of life; and all these have to be included in the conception of increased welfare. Economics has here to look for assistance, as Kant did, to psychology. There are two faculties which that study explains. The first of these refers to the imperfect form of the marginal economic estimate of equivalence. It is called 'relative suggestion', or more particularly 'suggestion by formal similarity'.¹ Two series which are in different kinds are comparable in their gradations, as when we speak of one colour being louder, or one note being flatter, than another. 'Consciousness of serial increases of differences is one of the most fundamental facts of our conscious life.'² So that we can say that one expenditure

¹ Stout, *Analytic Psychology*, vol. ii.

² James, *Principles of Psychology*, vol. i, p. 490.

EXPENDITURE AND POLICY

contributes as much *more* to defence as another does to education. But for the more perfect judgement of equivalence, in terms of general welfare, the doctrine given to us by psychology is that of 'implicit apprehension'.¹ 'A whole, with its characteristic unity, may be apprehended without definitely distinguishing its several constituents from each other.' It is thus that we apprehend what we call the general welfare, as we do the plot of a story which we have finished. But I think that we must carry this farther. What we mean by the general welfare is a form of intuitive judgement, but that intuition has been empirically developed, by experience of a certain national environment. Judgements of equivalent contribution to the general welfare are subject to the control of standards which have become empirically intuitive in a certain society. The Danish 'welfare', for instance, is different from the German. The substance of the judgement is usually what is 'optimum', and we cannot escape the problem of making such judgements by shifting to a 'maximum'.

The equivalence of final expenditures means that, in a given system of expenditure, there should be no absolute priorities. Every general purpose, and every special application within a particular purpose, must be capable of marginal comparison.

¹ Stout, *op. cit.*, vol. i, chs. 3-4.

PRINCIPLES OF EXPENDITURE

Every demand schedule for a particular sort of service breaks up into a number of schedules for each application of the service; and every unit of general expenditure is spent in part on each kind of service.

Marginal and Total Judgements

The method of equivalence in the returns on final expenditures, while it is an ideal to keep in view, has obvious difficulties in the private expenditure of an individual, and still more in the public expenditure of a nation. Therefore, there is a secondary basis for the method, which is a question of the total, not of the marginal outlay, and which is of considerable importance. I call these total judgements, absolute or relative.

✓We make an absolute total judgement when we quote, as a criterion of outlay, the actual figures of money spent on different purposes. This carries an *implication* of proper marginal adjustment, but it is used as a provisional index of whether that adjustment is right. Thus, there is the absolute fact that we are now spending 350 millions on armaments, the figure being left to speak for itself. Of course, such judgements are made at a time and in the conditions of that time; but the suggestion is that such figures are noteworthy or formidable at any time. For example, the national Budget in Peel's time was

EXPENDITURE AND POLICY

about 50 millions; it was actually moved¹ in the House that 70 millions should be an absolute limit. When the elder Churchill prophesied that it would come some day to 100 millions, this prophecy was regarded, according to his biographer, as 'unduly pessimistic'. When it did in 1895 reach that amount, the mere influence of this round figure led Gladstone to make his last alarmed reflections on our finance. Some years later, the country was warned by the younger Churchill that a 200-million Budget 'loomed portentous'. There is similar alarm now in face of the round figure of 1,000 millions. Or it may be that the social services are costing 'no less than 500 millions'. The appeal is to the average man, with his income in terms of hundreds. Proposals to ration the departments were made after the War in the spirit of such criteria, just as it was once proposed to ration the government.

It is more usual for total judgements to be relative to some index, such as the income, population, or area of a country, or the lapse of time. Relative estimates of this kind have played a great part in public finance, and they are often applied in private expenditure. Thus, an individual adjusts his expenditure by reference to the proportions of his income spent on different things; this is often his main criterion. Tithe was originally based on a judgement of this

¹ By Bright, with the support of Fawcett (1870).

MARGINAL AND TOTAL JUDGEMENTS

kind. In public finance, we have such a statement as Giffen's that 'a country which is not spending ten per cent. of its income on public purposes, should consider if it is spending enough'; while Bastable thought that 15 per cent. must be too much for government. A fuller argument was made by Giffen in his analysis of the *Wealth of Empire, and how to use it*.¹ Four per cent. of our income on defence seemed 'hardly enough'; 2 per cent. on education was 'scarcely creditable for a wealthy country'; 34 per cent. on food suggested waste; civil government was 'reasonable' at 6 per cent.; and he proposed 'continuous enquiry into actual expenditure, and the proportions of the total amount appropriated to each object'. Bastable also considered this index, since 'beyond the broad rule of aiming at the maximum result, it is not easy to reach any conclusion by the deductive method', so that 'no ingenuity of analysis can remove public finance from the domain of political science'. But he held that marginal equivalence must be retained as an indefeasible *idea*.² Adams held that it was 'the percentage of public expenditure to the gross income of society that provides a basis for judging the fiscal claims of a government'.³ It is natural that in cancellarian finance this should

¹ *Economic Enquiries and Studies*, vol. ii.

² *Public Finance*, pp. 136-8, 149.

³ *Science of Finance*, p. 37.

EXPENDITURE AND POLICY

be the predominant method of applying the rule of optimum distribution of expenditure, per head, per decade, or per amount of national income. And, once we are off the basis of business finance and monetary returns on expenditure, and there is no unit in which to measure returns on outlay, it is open to argument that proportionate judgements of this kind have a still wider range of application. The 'use of money' tends to dominate over the strict 'economy of expenditure'.

This index of amounts or proportions, secondary in theory but important in practice, has been applied to the getting as well as to the spending of the public revenue. It has been a question of the total or relative contributions of classes of the people. When direct taxation was a much smaller part of the revenue, the great Chancellors rejected this method of reckoning, in favour of considering the general reactions on the community of changes in customs and excise duties. As direct taxation came to be more fully used, the first idea was to make it and indirect taxation contribute equal amounts; thus the few rich would pay as great a total as the many poor. 'To reach and maintain an equality between direct and indirect taxation', was Harcourt's view of the 'constant policy of the country' for a time. At the turn of the century this equality was reached and there were arguments against a 'disturbance of this

MARGINAL AND TOTAL JUDGEMENTS

equilibrium'. A second idea was that both sorts of taxation should vary together in the same direction from some optimum position, such as 1874 or 1902, or from a pre-war as against a post-war position. These were absolute judgements. It is now the relative total judgement that is applied to classes and, though no progression of rates of taxation can be proved to be the strictly right one, the significance of the existing proportions can be directly appreciated, and it becomes the working index of the principle.

The 'surd'

It is a second qualification that, whether we use the strict principle or its working substitute, there must be no purpose of expenditure which is in a position to create a 'surd' by evading, not simply measurement, but any approximate comparison with other purposes. In a properly adjusted expenditure there are no absolute priorities. 'Necessities' are brought to a marginal comparison with 'luxuries'. In the distribution of private expenditure, taxation is a 'surd'; and in public finance it appears that military expenditure may claim a priority which gives it something of the nature of a 'demand note' on the country. That is because of its special relation to foreign affairs, and the specially problematical nature of the returns to be got from it. Panic has a special position in this field, and urgency may

approach panic. The fact that the modern State is so largely militaristic causes this fact to enter almost into the theory of public finance. The vagueness of the relation of this expenditure to the returns upon it is shown in the history of the phrases which have sought to determine its proper amount. Some of these seem to define a reasonable relation to the returns, such as Parnell's 'quality and measure of the danger to be provided against', or Disraeli's 'state of things which ought to exist abstractedly'; or such other phrases as the 'ordinary state of defence in which we ought always to be found', allowing for our 'moral power', and the 'part which it ought to occupy in the politics of the world'. We should not prepare 'for some midnight foray of a cordial ally' or build 'gigantic flotillas to meet mythical armadas'. On the other hand, if the country was to be 'properly defended', 'the best thing was to do it completely'. We must be prepared for a *coup de main*. 'You cannot, you are not entitled to rely on the forbearance of a stronger neighbour. You are bound to make your defensive measures proportionate to his means of aggression.' 'If you adopt the opinion of military men', said Peel, 'you would overwhelm this country with taxes in time of peace', and much later Salisbury was pointing out that 'according to military opinion, we are never safe'. In the latest phase, we have to be strong enough 'to

THE 'SURD'

negotiate at Geneva'; but though 'it is true that an increase in the armed strength of other nations who will co-operate for collective security may increase the power of the League', it remains that 'an increase of armed strength may also prove an added power in the hands of a possible aggressor'.¹ The expenditure which has this almost incalculable relation to its returns is about a third of the present Budget.

Expenditure which is merely contractual, such as the interest on debt, is not in the same position. The economy of either an individual or a nation must include elements of expenditure of this kind, since long-period arrangements have always to be made. The existence of running contracts does not *alone* interfere with the marginal equivalence of expenditure.

✓ It has been said that marginal equivalence 'is a difficult calculus, but statesmen must handle it as best they can, since there is no practical alternative'.² It is true that we cannot lose sight of a certain ideal, but any applicable theory has to take account of the importance of the secondary index of relative or proportionate distribution of expenditure, and this may also be the most practical way of dealing with the 'surd'.

¹ *Statements relating to Defence, 1936-8.*

² Dalton, *Public Finance*, p. 200.

EXPENDITURE AND POLICY

The Three 'Economies'

The principle that 'expenditure depends on policy' may be illustrated by a consideration of the three main economies, the business, the private, and the public.

In the business economy, the principle of expenditure is the most simple. The outlay and the income are both in terms of the same thing, money. Since there is a definite unit of returns, there can be a strict measurement. We can speak of the marginal equality, or the maximum total. This is the finance of capitalism. Expenditure depends on profit. Apart from public enterprises, the business principle may be, and sometimes has been, applied to some parts of the public economy, on the ground that some expenditure 'fructifies to the revenue' in taxation. But this is subordinate in public finance.

✓✓ In the private economy, some differences begin to appear. The expenditure is at the final stage, and aims at obtaining results in satisfaction or welfare. These are not in the same kind, since the former is subjective, while the latter may consist in creating objective conditions. What is 'best for' the persons on whose behalf money is spent is not always their satisfactions or expressible in terms of their satisfactions. As there is no unit of final real income, the business *measure* of equality has now to give place to

THE THREE 'ECONOMIES'

a *concept* of equivalence. This equivalence has reference to the *results* of expenditure. It does not mean merely that each final expenditure affects equally the mind of the spender. If that were so, there would be no criterion of good expenditure; there would only be a tautology. In the absence of a unit of measurement, private expenditure can only be said to aim at the optimum, not the maximum, result. The secondary index of proportional outlays will often have to be used. While the impossibility of adding the satisfactions and/or other results of private expenditure is usually conceded, this concession is often made in the form of an absolution, and even Marshall proceeds to speak of 'aggregate satisfactions'. But a main characteristic which separates both the private and the public from the business economy is that in the two former the spender is not the user or consumer of the results. Most private expenditure is made on behalf of other persons. This greatly increases the problem of equivalence. When he announced his new theory, Jevons assumed that the spender was the consumer, and his book has practically no reference to wife or child, friend, relative, or social interests. In this way, he obtained a wrong precision. The wide range of interests which represents 'one's-self' has been explained by William James in a classical chapter. It is 'the sum total of all that he can call his . . .

EXPENDITURE AND POLICY

with various grades of interest in the welfare of each part'.¹ In the private economy, the equivalence which is sought has therefore to be simply in terms of what is 'right'. This standard is more exacting than either profit or policy, because it is the personal standard.

When we come to the public economy, there are some differences. In the first place, as compared with either the business or the private economy, there is only a limited trusteeship. The State does not spend the whole national income. It is an aspect of policy, as will be seen later, how much of that income it will spend. That aspect of policy is special to the conditions of public finance.

✓ Citizenship is not exactly analogous to membership of a family or, as Adam Smith suggested, of a joint-stock business. The whole income of a family or a business is administered on behalf of its members by the agent which is in the position of trust; but the whole income of a nation is not administered by the government on behalf of its citizens. They are not in natural joint-stock, like a family, nor does citizenship mean that all one's resources are entrusted for administration, as shareholding means that some of them are. In the case of the State, the scope of entrustment does not correspond to the qualification of membership. For some purposes, such as defence,

¹ *Principles of Psychology*, vol. i, ch. 10.

THE THREE 'ECONOMIES'

the State is practically the sole spender, for others, like education, it is a part spender, for most commodities it is not a spender at all. The equivalence at which it aims is therefore a limited one, and the doctrine of policy expresses the variability of its trusteeship. The influence under which this varies is discussed later. It appears that a larger income, and a larger average income, increase the range of public expenditure, even though individuals are better off and can buy more things for themselves, partly because of the pure economy of collective expenditure, partly because of the need of increasing desirable expenditure and therefore of controlling it.

Second, the democratic State has a variable *standard* of returns in relation to expenditure. There is an alternation in the principle of reckoning. The public finance of an authoritarian State, where there is no such alternation, is the most conformable with the principle of marginal equivalence. Even then, the State, as has been said, 'keeps many ledgers', and the judgement of equivalence has to allow for subjective and objective results, equity between classes, and other considerations of political science. But it is an additional complication if the method of accounting also changes. Thus, one Chancellor commented on the position created if, by the standards of a particular party, 'all money spent on the navy must, and no money spent on education can,

EXPENDITURE AND POLICY

be wasted'.¹ Instead of a frontal development of public expenditure, the process is apt to be one which alternates between the special interests which are favoured by different parties, so that lags are taken up by successive governments in respect of expenditures which they value more highly than do their political opponents or predecessors. The equivalence between different lines of expenditure is therefore reached by a sort of echelon. 'There is always', said Disraeli, 'some large question which cannot be shelved or shunted, either from the peculiar interest which the country takes in it, or the engagements of successive Ministers.' This kind of substitution may cause expenditure to increase faster than, in a single-party State, it would do, in so far as successive governments have to accept a condition of expenditure from their predecessors, and endeavour to bring their own special interest into line; just as a university, which receives an endowment for a special purpose, appeals for more money in order to keep a balance between its branches of study. The alternations of party governments may, by this rivalry of interests, improve the 'use of money' by maintaining pressure on new purposes of expenditure, and preventing the range from being limited by the ideas of

¹ Cf. his reference to 'enterprises for which a Liberal Administration is not naturally fitted' (*Lord Randolph Churchill*, vol. ii, p. 315).

THE THREE 'ECONOMIES'

any one class or party. 'Such panics', said Goschen of a naval scare, 'come to the rescue of the Departments after they have been unduly weakened by great fits of economy.' This aspect of the problem of equivalence has, however, some degree of mitigation, so far as the difference between parties is no longer a contest between expenditure and retrenchment, but one between different expansions of expenditure. 'We have merely to imagine', says de Viti de Marco, 'that the alternation of the groups in control of the government takes place with sufficient rapidity, and we finally come to consider as practically identical the groups that are in turn governing and governed. This brings out the concept of the co-operative society.' Borrowing a recent phrase, I call this later the 'common propensity to consume' public services of one kind or another.

The third point is that the standard of judgement in public expenditure is not profit, nor rightness, but policy. The equivalence is in terms of what is politic, and States are not persons, and are not charged to do all that persons would consider 'right'. The limited trusteeship is one aspect of this. But, even within its range, the State does not look to many reactions which are 'not its business'. It is not to be 'paternal'. Policy is morally a thinner idea than rectitude.

EXPENDITURE AND POLICY

Retrenchment

In its actual application, the doctrine of policy has had two periods in British finance. In the first, 'expenditure depends on policy' was a warning; this was the era specially called the era of retrenchment. It was possible then for a Chancellor like Harcourt to protest against 'the fatalistic doctrine of progressive expenditure'. In the second period, the same phrase has gathered round it a less critical atmosphere.

What is to be said for the doctrine of retrenchment? It is, of course, not simply a protest against waste; it is a principle of the use of money. Even in these days, an ex-Minister can write as follows: 'All the financial operations of the State are an unmitigated evil which is, unluckily, necessary. It is an evil, though a necessary one, that the State should have to collect and spend a revenue. A tax is a bad thing and not a good thing. Could we do without taxes altogether, we should all be better off.'¹ And Sir Josiah Stamp concludes his book with a eulogy of the lady who 'took the tax away', though it is not by this method that every great financier has made an 'immortal name'. It is too theoretical to discuss industry and trade by regarding the cost of production as an 'imperfection' of the former, and the cost

¹ Lord Kennet, *System of National Finance*, fin.

RETRENCHMENT

of transport as an 'imperfection' of competition. As we live in space, and need to work, so we must have all that good government implies.

Retrenchment has had two meanings, one of them more special and the other more general and lasting. In the first place, it has been a post-war appeal against the tendency of expenditure to be stepped up after a war and to remain on a high level. This does not mean only that there then takes place an increased debt charge or that prices are higher. Apart from that, war causes the principles of expenditure to become demoralized and to give way for a time to sheer 'affordability'. The nation gets accustomed to large figures, and a given sum of money comes to have less significance. 'The civil expenditure', said Gladstone, 'and the temper of the House are infected with the habit of extravagance. War of necessity means ruthless extravagance.' The danger to be contended against was the stabilizing of large changes in expenditure by finding new uses for the money. In part, this may be due to a feeling that the life-sacrifices of war should be followed by a similar 'conscription of wealth'; or it may be that special increases of the public control over incomes during war, such as the allowances to the dependants of soldiers, should be carried on in another way. A great war both increases the function of government and creates familiarity with larger figures of expenditure. It

EXPENDITURE AND POLICY

is apt to reveal what the real taxable resources of a country are, and to act as an experiment in the distribution of income. Hence the former dread of the income tax, as being properly a war reserve, which was apt to presume in peace on its war services, and to lead us, as was Gladstone's prophetic dread, to some kind of Socialism because of its very efficiency. But there has been another aspect of the special meaning of retrenchment. There was a phrase about the 'ignorant impatience of taxation'.¹ This is a long-standing misquotation. The phrase was used by Castlereagh at the end of the French War with particular reference to immediate post-war finance. He hoped that the nation would not, through an 'ignorant impatience to be relieved from the pressure of taxation, again put everything to hazard'. He thought it was dangerous to neglect the international conditions that were created for a country even by a successful war, and to assume that military expenditure could be quickly retrenched in face of the animosities which must persist. The aftermath of the Great War in this country is still a comment on this view. So that, in a country which has obtained franchise 'reform', one danger

¹ Cf. Hobbes: 'Men are by nature provided of notable multiplying glasses, through which every little payment appeareth a great grievance; but are destitute of those prospective glasses to see afar off the miseries that hang over them, and cannot without such payments be avoided' (*Leviathan*, Part I, ch. 18).

RETRENCHMENT

was that peace might not bring retrenchment, the other that it might bring the wrong retrenchment.

In its more permanent aspect, retrenchment has been a well-intentioned theory of employment, but an imperfect, because undeveloped, theory of collective expenditure. It is easy to misunderstand it, by emphasizing the latter to the neglect of the former. It has been said of Gladstone that, in his view, 'the cost of any policy would generally be about the sole element in deciding its desirability'. This scarcely does justice to the outlook of the classical era of retrenchment. If Gladstone thought that expenditure beyond the 'legitimate wants of the country is not only a pecuniary waste, but a great political and, above all, a great moral evil', it must be remembered that he was most at home in an issue when he had put it on a moral basis, as some one has said he would have done if it had been the short-suit lead or the six-ball over. He was aware of 'the increasing and expanding wants of society, and you must in the future look for a growing and steady augmentation in these demands'. And so with others, at that time and since. The point about the theory of retrenchment was that it put employment very high among the 'legitimate wants' of the nation, higher even than cheapness, and that it had a strong view of the relation of taxation to employment.

EXPENDITURE AND POLICY

‘It is a mistake to suppose that the best mode of giving benefit to the labouring classes is simply to operate on the articles consumed by them. If you want to do them the maximum of good, you should rather operate on the articles which give them the maximum of employment. What is it that has brought about the great change in their position in recent years? Not the mere fact that you have legislated for the purpose of taking a penny or twopence in the pound from some article of consumption. That is good so far as it goes; but it is not this which has been mainly operative in bettering their condition. It is that you have set free the general courses of trade. It is the enhanced price their labour thus brings that forms the main benefit they receive.’

In this statement Gladstone was repeating the general view of the time. ‘The best way’, Althorp said, ‘of relieving the burden of the labouring classes was to give them employment; and this could only be ensured by reducing the taxes which pressed most immediately on the productive industry of the country.’ This was the fulcrum of the argument of Cobden and of the Import Duties Committee. The issue between Free Trade and Protection was not stated merely as one between cheapness and employment. Retrenchment banked heavily on the elasticity of the effectual demand for goods and labour, and the chain of its argument went from taxation to employment, from employment to consumption, and so back to the revenue and to still lower rates of taxa-

RETRENCHMENT

tion.¹ Any surplus was to be at once given away by remissions of future taxation. While the motive of retrenchment was not harsh but sympathetic, the form of its argument became less tenable as the income tax, which does not go on prices, became more important; and, up to the War at least, the ground shifted to the restriction of enterprise by that tax, and still later to aspects of 'taxable capacity', on which ground it now stands.

It was natural that, among ideas of finance, retrenchment should prefer the company of 'economy' to that of 'efficiency'. Since the return we get for military expenditure is vaguely conceived, efficiency may always be an easy excuse, in this field in particular, for an indefinite limit of outlay. If the nation

¹ The 'elasticity of demand' is a phrase first used by R. S. Moffatt (*Economy of Consumption*, 1878, p. 122) to express an idea which was first definitely formulated by Whewell in 1829. In its complete form, it should be a function of change of price, change of quantity consumed, and time of adjustment to change. Although recognizing that 'in economics the full effects of a cause seldom come at once', Marshall did not include the time-element in his expression of the formula. In British finance the income tax was brought in to bridge the interval between the fall of prices and revenue and the compensatory increase of consumption and of future revenue. But the impulse to remove duties altogether impeded this result, which might have given a system of low duties, the 'true free trade' which Disraeli attributed to Pitt and Huskisson. It was for this reason that the income tax remained in such an ambiguous position, being constantly demurred to and continued till well into the present century.

EXPENDITURE AND POLICY

must be defended, 'the best thing is to do it completely' or 'we are never safe'. Other establishments may also present the same kind of claim, to which rationing is the only final answer.

'Hitherto we have understood', said Disraeli, 'that retrenchment and not efficiency was the parent of economy. I think it is the duty of an administration to look to the efficiency of the establishments, and not to the rate at which they can be maintained. If you only make your establishments efficient, you will save money; and therefore I take it that efficiency, and not retrenchment, is the true parent of economy.'

To which the champion of retrenchment replied later that

'if you intend to have any limit put on expenditure, it is high time that you should be on your guard against efficiency. Efficiency in itself is a very good thing; but in the mouth of a Minister who wants to find excuses for a great increase in the public burdens, it is a plea that ought not to be admitted without a great deal of carefulness.'

An exposition of how economy turns, via efficiency, into an increase instead of a decrease of expenditure is given by Mr. Churchill for the military services.

'It may begin in all undivided earnestness in a simple demand for the reduction of expenditure. That is the first stage. . . . But in the process of the controversy, the movement has been insensibly and irresistibly deflected from the original object. It began in a cry for economy; it has become

RETRENCHMENT

a cry for efficiency. That is the second stage. . . . The third stage becomes an agitation in favour of an increase of expenditure and a more lavish establishment'.¹

It is only the working criterion of proportional outlays that can control this conflict of ideas. On the whole, its influence is on the side of what was understood by retrenchment.

The defect, from one point of view, of the idea of retrenchment was the undeveloped, rather than imperfect, theory of taxation. The principles of collective expenditure had to begin to be perceived some time. Considering what is now done with tax revenue, take Bright's definition of taxes:

'What do taxes mean? They mean bareness of furniture, of clothing, and of the table in many a cottage. They mean absence of medical attendance for a sick wife, of the school fees of three or four little children, hopeless toil to the father of a family, penury through his life, a cheerless old age.'

The policy of maintaining employment, so as to enable working people to buy for themselves what they want, is even theoretically defective, if there is expenditure which is socially desirable beyond what individuals would make it, and if collective supply is economic. Incomes will buy the goods, or their equivalent, on the prices of which they are based; but we may apply to the public sphere the observation that 'the rejection by an industry (or service)

¹ *Lord Randolph Churchill*, vol. ii, p. 313.

EXPENDITURE AND POLICY

of an improvement by which its efficiency could be increased ten per cent., inflicts an injury measured by ten per cent. of that part of his wages which he (the operative) spends on the products of that industry (or service).¹ And so, though the Budget of 1874, with its minimum of direct and indirect taxation, was a beauty, its beauty was only skin deep.

Expansion

It was in the eighties that the maxim of policy began to become an expression of action. That decade saw the foundation of societies and federations and movements which had a new attitude towards the function of the State. By 1889 it was possible for Harcourt to say that 'we are all Socialists now'. Goschen, whose essay on *Laissez-faire* in 1883 proclaimed its end, was the Chancellor who reflected in Parliament the new influences. Expenditure was now to depend positively on policy.

'We ought to enquire whether the country does not now require a number of services which were not called for previously, and whether the whole standard of government has not been raised. There are three ways in which expenditure can be increased, when more work is required to be done by the nation, when its servants are paid higher, or when there are more persons to do the work.'

For about twenty years there flowed together, like

¹ Marshall, *Principles*, p. 539.

EXPANSION

the blue and white Niles, the stream which took its source from these ideas, and that which came from the old sources. The latter was chiefly represented now by Harcourt. There were 'no economists now'. Economy was 'a lost art, a despised and unfashionable idea'. 'A Chancellor preaching against extravagance is the voice of one crying in the wilderness.' Although, of course, Parliament continued to debate economy, it was now within the ambit of new ideas. In 1894 Goschen was led impatiently to describe as 'bunkum' the charges against the expansion of expenditure. Asquith, who had shown hankerings after retrenchment, accepted in 1907 the needs of 'the whole still unconquered territory of social reform'; even in that year he had thought it worth while to say that the income tax must be finally let into the financial system. Though it is now commonplace to us, Mr. Balfour's statement in 1906 was significant at the time:

'If you look at the source of the growth of national indebtedness and expenditure in the last thirty years, you will find that all the increase is due to the desire of this House to ameliorate the social position and to carry out great reforms; and, as that has cost money in the past, it will in the future. All the forces of political life—not corrupt forces, but honest, honourable and patriotic forces,—move in the direction of increasing and not of diminishing expenditure.'

A good index of this change of outlook is given by

EXPENDITURE AND POLICY

the fact that the gross national expenditure, which was 50 millions in Peel's time, had not been doubled until 1895, but was doubled again by 1914. The proportion of the national income which was spent by public authorities, central and local, remained at about 13 per cent. from 1840 to 1880, or increased only from 8 to 10 per cent., if the debt charge is excluded; this is the mark of the first phase of expenditure as depending on policy. By 1914 it was about 17 per cent. on either reckoning, and is now about 30 per cent. What was in process of creation is what may be called 'social Socialism'. That programme has, on the national scale, so far anticipated industrial Socialism as to have greatly lessened the impatience for the latter programme, if not the argument for it also. It is not certain what Harcourt meant when in 1889 he made his famous statement, for the occasion of it cannot be traced; but Chamberlain, in the 'unauthorised programme', had frankly defined his policy in 1885 as Socialism in every part, the 'death-knell of *laissez-faire*'. 'Of course it is Socialism. The Poor-Law is Socialism. The Education Act is Socialism. The greater part of all municipal work is Socialism.' It was such a use of the word which Mr. Hubert Bland, in the last of the Fabian Essays, described as the 'sham Socialism' which was to be carefully watched; 'the hope that mere State action will be mistaken for really Socialist

EXPANSION

legislation'. Mr. Asquith, indeed, on the Budget of 1909 could declare that 'I do not suppose there is any Budget for the last thirty years in which the microscopic eye, and sweeping and soaring imagination, could not discern traces of Socialism. . . . Each side can convict the other a hundred times over of being impregnated by the principles of Socialism.' Yet no one could say that industrial Socialism, as properly understood, had made any great advance at this time; for municipal trading is conceded to be of a different kind, and to furnish no general argument for the public ownership of transferable goods not limited in their markets. Even the graduation of the income tax, which began to be more favourably canvassed in the eighties, ever since the unauthorized programme spoke of 'ransom' and 'insurance' for idle incomes, and which seems to have been connected with Harcourt's statement, is no more than social Socialism. The policy on which expenditure came to depend from this time onward included, as a special feature, this form of Socialism in the public services, and increased their cost from 22 millions in 1891 to over 500 millions in 1935. This is rather a condition of the survival of capitalism than a diminution of its status. There is an analogy between the ideas of defence and security as between States and as between Capital and Labour in the democratic State. There are 'minimum needs of survival' for Capitalism,

EXPENDITURE AND POLICY

charges which it has to meet if it is not to be too open to attack; it may be 'disarmed to the point of danger' if these charges are not duly incurred; and it has 'collective security' with its rival only so far as its sanctions against the breakers of industrial peace are accepted by Labour as proceedings against disorder, and not as repressions of fair claims for 'treaty revision' of the balance of power.¹ It was in this way that Chamberlain brought in his programme under the titles of 'ransom' and 'insurance'. He said that, 'I asked the other day, what ransom will property pay for the natural rights which have ceased to be recognised? I will put the same question now in another form. What insurance will wealth find it to its advantage to provide against the risks to which it is undoubtedly subject?'² This was more than Adam Smith's remark that 'the affluence of the rich excites the indignation of the poor'. Chamberlain's idea, according to his biographer,

'was, that the rich and comfortable, who gain most under a flourishing State, cannot create or maintain by themselves the conditions of their own security; that the normal subsistence of the common people and their services in peril, support and uphold all; that in this manner their contribution to economic prosperity includes an unpaid factor over

¹ Cf. MacIver, *The Modern State*, p. 369, on the 'defensive attitude' of Capital in politics, and the 'weaknesses of its legal position'.

² At Birmingham, 14 Jan. 1885.

EXPANSION

and above the value and reward of their immediate labour; that the well-to-do should provide the expenses of the State in proportion to their advantages derived so largely from the general system; and that they owed more than wages to the masses.'¹

This form of the theory of the 'social net product' of labour can be based on other considerations also. It can be related to the 'poverty figures'; these were taken at the end of a century during which real wages were said to have increased four-fold to show that wages at market values did not buy minimum subsistence, so that they had to be regarded as 'provisional advances' out of the national dividend. Or it can be related to the imperfect realization, in the period of retrenchment, of the nature of collective economy, and to what may be called the 'restoration of the commons' to the people, after our national life had changed from an agricultural to a manufacturing and commercial basis.² That the leader of the Conservative Party could repeat, a few years ago, a phrase used by Harcourt in the sense of a promise fifty years earlier, shows how distinct this kind of Socialism is from the industrial proposals of that school. It was the danger that these agreed reforms might take the place of the outright programme that Mr. Bland thought he foresaw. When

¹ Garvin, *Life of Joseph Chamberlain*, vol. i, p. 551.

² See my *Evolution of Industry*, 1931, p. 136.

EXPENDITURE AND POLICY

expenditure came to depend on policy in the second phase of that expression, retrenchment retired, and it was social Socialism that became the substance of the matter.

To this policy, the fiscal resources had to be made adequate. There was a continuous warning by Chancellors that the sources of revenue had been diminished by the Peel-Gladstone finance to the point of danger. And it had not even been finally agreed that the income tax was to remain. Since the Sinking Fund was then regarded as one of our great reserves, raids upon it, which served Goschen for a while, were no final solution. So that graduation of the income tax began to be spoken of with more favour. Here, as I have said, the theory was broken down by the needs of finance. There would have had to be graduated taxation whatever the theory of how the value of money was affected by the size of incomes; even if it had increased with increasing incomes. 'The question as to a varying rate (of income tax) is a question between the air and the clouds; it has never been practicable,' said Gladstone in 1857. But when Goschen made the breach with a special estate duty in 1889, which he related to a corresponding size of income, even Gladstone abandoned any argument of its injustice; and Harcourt said that 'it is a characteristic of stones of this kind that, when set rolling, they acquire the peculiar property of rolling faster

EXPANSION

and faster'. It is difficult for us now to appreciate the recentness of this finance, and the arguments by which it was opposed. It had to be either graduation or a tariff. When a 200-million Budget 'loomed portentous', Mr. Churchill was led to surmise 'what would happen if the fair trade issue was openly raised. They would stand once more on the old battle-fields, with all the old broken weapons, and amid grass-grown trenches, and the neglected graves of heroes who had fallen in former conflicts.' This happened a year later; but it was possible by 1914 to more than double the Budget without changing the basis of the system of revenue.

Finance came to depend on policy, not policy on finance. It was policy which caused the full possibilities of finance, and the full resources of taxable capacity, to become apparent, while retrenchment had lived in a world of meagre sources of revenue, and the alleged impossibilities of graduation. Harcourt fought the rear-guard action of its retreat; his peroration in 1903 on the 'sovereign remedies of retrenchment and reform' was a fading echo.

Standard and Continuity

I have referred to the problem of deciding how exactly the judgement of the equivalence of expenditure is to be regarded as being made in the long run, especially in a democratic State, where there is some

EXPENDITURE AND POLICY

alternation of the standard by which the results of different purposes of outlay are compared. How far can there be said to be continuity, and which is the influence that serves to maintain it?

In a democratic State, the alternation of party governments is an influence which tends to increase the range of policy, or the 'use of money'. The franchise of 1884 also dates the beginnings of the new argument on social policy. In an autocratic government or dictatorship, the insecurity of the ruler may be an influence towards keeping alive the claims of different sections of the nation; that kind of government, in view of the sacrifices it asks in other ways, has to be active in finding ways of doing new things for everybody, as a condition of its survival. Militarism and social policy have been remarkably co-ordinated under the existing dictatorships, while the British democracy tends to have lags in different expenditures, which are taken up by successive governments. Until 1884, the 'echelon' of social advance had not had its fully necessary political conditions. The prevalent aspect of financial policy was that, if we could manage to spend less on armaments, we could positively reduce the expenditure of the country altogether.

Is there, in a democracy, any influence which, over a period of time, tends to compromise this difference of interests, and to act as a substitute for

STANDARD AND CONTINUITY

the single control of expenditure which exists in a dictatorship, a business, or a private economy? This is a question of the relations to each other of three authorities: the Treasury, the House of Commons, and the Electorate. The evidence is that 'Treasury control' did for a time provide some influence of this kind, but that, as policy became expansionist, its place was taken by forces of a more general sort.

Mr. Churchill has pointed out how, at one period, successive Chancellors came under the influence of the Treasury tradition and were shepherded into right lines of policy.¹ The doctrine of Treasury control would be convenient for theory, since it would mean that successive governments were affected in their policies by the influence of a permanent judgement. The 'resumption of Treasury control' has sometimes been suggested as a means of maintaining the economy of expenditure, but the conditions have changed too much. In the days of strong Treasury control (apart, that is, from its control over the efficiency of expenditure when policy is decided) there were few items of policy. It was possible to speak of rationing the departments in their administration of the civil services, in a manner which implied control over policy. 'It used to be the distinguishing feature of the British administration,' said Parnell, 'that the Treasury was its heart; everything flowed from it as

¹ *Lord Randolph Churchill*, vol. ii, pp. 179-80.

EXPENDITURE AND POLICY

the commanding centre; the other Departments were necessarily subordinate.' This principle had certainly persisted up to the time of Harcourt. The Treasury was a 'watchdog' over the departments; its function was to scrutinize all proposals involving expenditure, and to be critical of any which implied increases of expenditure. This appears to have placed a very special responsibility on the Chancellor; for 'the control of the Treasury is neither more nor less than the personal influence of the Chancellor upon the Cabinet'.¹ A large measure of continuity was possible so long as there was an accepted principle of economy, so long as the contentious questions of expenditure were few and similar (military expenditure being always predominant), and so long therefore as the permanent officials were to some extent expert in the criticism of technical proposals. 'The total of an item varies from year to year in a more or less regular sequence. Every item has its history and its trend of development. Information is kept up to date. Each note thus has a pamphlet attached to it which is of some assistance in checking the Departmental estimates.'² In these conditions Treasury control was rather 'efficient' than 'active', its censorship being in accordance with a prevailing view against increases in the range of policy.

¹ W. S. Churchill, *Life of Lord Randolph Churchill*, vol. ii, p. 184.

² Jennings, *Cabinet Government*, p. 126.

STANDARD AND CONTINUITY

The cancellarian principles of this system were stated by Gladstone as follows. First, the Chancellor must resist expenditure which he does not think proper; second, support the expenditure agreed on by the Cabinet, and not disparage it; third, accept a responsibility next to that of the Prime Minister and the Minister directly concerned; fourth, consider, and advise the House on, 'the relations, the course, and the prospects of both revenue and expenditure'.

When, even in the twentieth century, the resumption of effective Treasury control was advocated, what was in view was the tendency for changes amounting to changes in policy to arise in the spending departments, especially the service departments. But this is a peculiarity of the service departments. Changes amounting to changes in actual policy do not arise in that way in the estimates of the other departments; they were especially connected with a close relation between strategic policy and expenditure in military affairs. Changes in social policy arise in the Cabinet.

Hence 'the acceptance of collectivist principles by all political parties has much reduced the area of Treasury control'.¹ This change was explained by a Financial Secretary to the Treasury after the War.

'In Mr. Gladstone's day the subjects of expenditure were

¹ Jennings, *op. cit.*, p. 130.

EXPENDITURE AND POLICY

few, and if a Minister was turned down by Mr. Gladstone, and appealed to the Cabinet, he would have a hostile Cabinet against him, which in nine cases out of ten would back the Treasury. The whole outlook to-day is changed . . . and all large items are controlled, not by the Treasury, but by the policy of the Government, and if the Chancellor raises objection, and the Minister takes the matter to the Cabinet, the natural bias will not be against the expenditure but in favour. . . . So far as expenditure is controlled by policy, the House of Commons itself would in nearly every case support the Government which was spending the money on purposes of social amelioration. The Treasury then has to sanction these amounts. There is the essential difference between the position of the Treasury a generation ago and its position to-day, and the office is often criticised for not exercising a power which it has no right to exercise.’¹

In addition to Treasury sanction, the social legislation of Mr. Lloyd George was thought to create a new condition which made the Treasury itself a spending department. It is not clear that this is what happened. It fell to the Chancellor to introduce the new legislation, and to provide the funds, but he spoke as a representative of the Cabinet, and the Treasury remains responsible for the estimates of the administrative bodies which were set up.

If Treasury control did not provide the same continuity of policy as before, were changing governments under any other continuous influence? Over

¹ Mr. S. Baldwin, 1919.

STANDARD AND CONTINUITY

a long time, Chancellors attributed to the House of Commons a constant pressure towards larger expenditure; and this could of course be referred back to the electorate. 'Allow me to record my testimony', said Mr. Asquith in 1921, 'which is that of every Chancellor for generations, that on the whole the influence of the House of Commons is exercised in favour of larger rather than reduced expenditure.' This is in accordance with the protests of all the Chancellors since Peel's reforms.

'It is not at all uncommon for a Chancellor who is generally charged with being a wasteful administrator to be told, the moment he gets out of these walls, that he is refusing money for the most necessary and advantageous expenditure.' (Wood, 1849.)

'It is the government which has been the great advocate of economy, and it is the different sections of the House which have been the great advocates of expenditure.' (Lewis, 1858.)

'The struggle against expenditure is always a struggle between the government and the public, or between the government and public events.' (Disraeli, 1859.)

'I heartily wish that the House would put pressure and duress upon me to make me more economical than I am. But what are the facts? It is for meanness I am reproached, for niggardliness, for want of generous sympathy, for the absence of everything which tends to the proper expenditure of the public money.' (Lowe, 1852.)

'The tendency of the democratic spirit of the age is

EXPENDITURE AND POLICY

to make the sovereign people a most expensive sort of sovereign.' (Northcote, 1883.)

'Of all the spending Departments the House of Commons is the worst. In five years, our navy expenses have gone up 40 per cent. (*cheers*), and our expenses of education have gone up 43 per cent. (*cheers*).' (Hicks Beach, 1897.)

'The Departments cannot keep down expenditure without the House of Commons, with which rests the first and last responsibility. The Exchequer is pressed from two quarters, to spend more, and to charge less.' (Lloyd George, 1911.)

Hence Disraeli's reference to the Gladstonian paradox of 'a Chancellor denouncing as profligate the expenditure for which he is applying at the same time the ways and means, proposing votes with innuendo, and recommending expenditure with a whispered invective'.

This is the common propensity to consume public services, which the era of retrenchment held under restraint; defined by Gladstone as 'a spirit of expenditure, a desire, a tendency proceeding in the country which, insensibly and unconsciously perhaps, but really, affects the spirit of the people, of Parliament, and of the public Departments'. Gladstone disclaimed every doctrine that would entirely absolve the Chancellor, or that 'expenditure and revenue are for the people to manage, as distinct from the House of Commons and the government', and added:

'I admit and assert the responsibility of the government:

STANDARD AND CONTINUITY

I admit and assert the responsibility of this House: and therefore I say that, in this country of free institutions, where thought and feeling pass and circulate freely, vigorously and powerfully between the people and their representatives, it is vain to think of materially influencing the policy of Parliament unless persuasion be carried home to the minds of the people.'

This was a characteristic 'mixing' of the problem.

The problem itself, how expenditure is to be regarded in a democracy as in some approximate manner adjusted to a long-period equivalence of results, is somewhat mitigated by this consideration, because one set of interests, the military for instance, becomes reconciled more easily to another, such as the social, when there is a general opinion in favour of going forward. The spirit of retrenchment rather impedes the estimate of results in relation to outlay, as was seen in the rationing proposals. But when finance becomes expansionist this necessarily brings into fuller consideration the purposes of expenditure and the relative advantages of each purpose. The theory of public finance must apply to a possible political condition, and a State is not quite like a person or a business, so that we can get only as near as that condition allows to the working of the optimum principle. I think that de Viti de Marco, in supposing, in a passage already quoted, the alternation of parties and interests to take place 'with sufficient

EXPENDITURE AND POLICY

rapidity' to give continuous all-round equivalence of expenditure, is imposing the claims of theory too strongly.

It must be admitted that the result is, but perhaps necessarily, rather vague. Some attempts to express it may be tried. I would prefer something nearer than the 'general will'. Gladstone set an 'ignorant patience of taxation' against the doctrine of 'ignorant impatience'. Neither of these represents the active interest in the growing purposes of expenditure in more recent times. Let us try again, with the 'consciousness of consent'. The new level of budgetary expenditure is being borne in a way which implies some such temper. We go back to Sinclair's statement that taxation is not accompanied with 'disgust or oppression', if the rule is observed 'never to exact from any individual a sum which, consistently with his circumstances and the situation of the public, he ought not, on any principle of justice, *spontaneously* to have given'.¹

¹ *History of the Public Revenue*, Part I, p. 26.

II

FRUCTIFICATION AND RESERVE

THE second line of thought in cancellarian finance with which I wish to deal is connected with the idea of 'fructification' and has many applications.

An Aspect of Taxation

In a general way, this idea has always represented one mood of the theory of taxation. We have all heard of the 'rare and refreshing fruit' by which a new phase of the social policy was described. Long ago, Coleridge spoke of taxation by the same metaphor:

'A fuller and fairer symbol of taxation, both in its possible good and evil effects, is to be found in the evaporation of waters from the surface of the planet. The sun may draw up the moisture from the river, the morass, and the ocean, to be given back in genial showers to the garden, the pasture, and the cornfield; but it may likewise force away the moisture from the fields of tillage, to drop it on the stagnant pool, the saturated swamp, or the unprofitable sand-waste.'¹

A century later, on the Budget of 1917, it is held that 'a tax is like the sun. It draws up the moisture from the sea, and sends it back in the form of rain to

¹ *The Friend*, vol. ii, Essay 3.

FRUCTIFICATION AND RESERVE

some other part of the earth's surface.' Still later, a Chancellor reminds us that 'there is that scattereth and yet increaseth; and there is that withholdeth more than is meet, but it tendeth to poverty'. In public as in academic discussion, this theory of fructification has contended with that of the cost of modern democracy. The most gloomy fiscal view of life was that of Lowe, when he said that 'it is desirable that men should pay taxes, and in order to pay taxes they must live'. Just before the War the Attorney-General asserts that 'every tax affects adversely the general capital of the country . . . if possible money ought to be left to private profits'. And even Asquith and Lloyd George, the authors of new forms of impost, are found after the war holding that 'the effect of an income tax is, not merely to curtail the enjoyments and comforts of a large number of our middle classes, its effect is to dry up the streams which fertilise the whole field of employment and of industry'; and that 'all taxation must be a tax on industry. . . . Although the Colwyn Committee decided that the income tax should not be regarded as a tax on industry, I agree that in the main it does drain industry of the resources which ought to be made available for development.'¹ Of course taxation is meant to fructify, and of course it is a substitute for some other private expenditure.

¹ Asquith, 1923; Lloyd George 1930.

AN ASPECT OF TAXATION

There are no general statements which can disregard the questions of the basis, the source, the amount, and the application of taxes at each time.

The fructification of taxes *to the revenue* was, as has been seen, a special aspect of the doctrine of retrenchment. Mr. Asquith returned to this when the costs of the social policy were mounting, pointing out that, while expenditure on such things as education 'appealed to our higher nature', it did not 'grease the wheels of finance' like expenditure on the Post Office. This is a confusion between taxation and public industry.

The Special Theory

But these are minor aspects of the question. The special importance of the doctrine of fructification has been in connexion with the policy of the repayment or incurring of debt. As regards repayment, we see in almost every Budget over a long time a conflict between two views of the Sinking Fund, which may be called the long and short views. Is it important, or relatively important, to repay debt? Is this a really 'fruitful' use of public money at any time, or at all times, or from some long-run point of view? The other side of the question raises the issue of solvency. May it be in some ways 'fruitful' to let the debt increase? Ought there ever to be deficiency finance of a purposeful kind? Should the

FRUCTIFICATION AND RESERVE

fructification of expenditure be usually or only at some times limited by the condition of solvency? It is out of the argument on fructification that there has been developed in some quarters a case for unbalanced budgeting, which was once contrary to all accepted principles.

The original statement of fructification is usually ascribed to Gladstone. It has, however, a much longer history. It is quite distinct from the general maxim of the economy of taxation, as stated by Adam Smith, that the State should 'take and keep out of the pockets of the people as little as possible over and above what it brings into the public Treasury', or Parnell's similar phrase in his treatise.

In the Budget debate of 1832 Mr. Poulett Thompson, then Vice-President of the Board of Trade, afterwards Lord Sydenham, set the ball rolling:

'How did it (the deficit) arise? Was it from a diminution of our resources, a falling off in the produce of taxation; was it by unworthy extravagance or lavish expenditure? No such thing. . . . It has occurred neither by unworthy extravagance nor by diminished revenues, but by the government abstaining from demanding so much from the people. It was not money wasted nor money lost. It remained in the pockets of the people, to be drawn therefrom if the necessity of the State should require it. . . . It remained in their pockets, there to fructify by use, to stimulate the effects of their industry, and to add to the resources of the State. . . . Where

THE SPECIAL THEORY

would have been the benefit to have extracted that money from the pockets of the people with the mere view of making a surplus, instead of allowing a deficiency?’

Peel had said two years earlier that the remission of taxes would make money ‘fructify more in the hands of the people than in those of the State’, but to this defence of a deficiency he now replied:

‘The right honourable gentleman had a theory perfectly novel. He said that we ought to regard with something like satisfaction the deficiency in the revenue, because it was not in fact money lost, but was in the pockets of the people ready to be extracted on any occasion that might require it. This speculation in finance the right honourable gentleman designated by a name which would not soon be forgotten; which would, he hoped, ever continue to belong to the right honourable gentleman, without a rival claimant. He called it the ‘fructifying’ principle. Thus, should the government not have the money to pay the interest of the national debt, the creditor would have no right to complain of his loss, because the money was ‘fructifying’ in the pockets of the people.’¹

In 1840 Melbourne argued whether the Chancellor should budget for a surplus or ‘leave the capital to fructify (using a term that had been much ridiculed, but was not on that account less apt) in the pockets of the people’, and denied that there was any principle. It was on the Budget of 1867 that Mr. Gladstone, replying to a quotation of Sydenham’s statement,

¹ *Speeches*, vol. ii, p. 457.

FRUCTIFICATION AND RESERVE

saddled the phrase on himself. 'It appears to me that that is not a just or a true statement of the case, and that when you talk of the fructification of money—I accept the term, which is originally due to very high authority—for the public advantage, there is none more direct and more complete than that which the public derives from money applied to reduction of debt.' In 1899 the Chancellor disagreed with Sydenham's case for deficits, as alternative to adequate provision for debt. In 1914, the phrase was quoted with favour, and ascribed to Harcourt. In 1923 Snowden referred the phrase to Gladstone, and argued as he had done. These are the chief public references; Mill took up the discussion in economic literature, and endorsed Gladstone's opinion, provided that repayment of debt did not mean the continuance of the 'worst' taxes.¹

The Short Period

In practical finance, the position is that, among purposes of expenditure, repayment of debt has a low marginal value or esteem for short periods, but a very high long-period marginal value. The Sinking Fund has always lived in a dilemma.

The low public esteem, for short periods, of debt repayment, in relation to other purposes of finance,

¹ *Principles*, 5. 7. 3.

THE SHORT PERIOD

has often been expressed by the Chancellors, and the following statements are among the most typical.

'A Sinking Fund is a thing made to be robbed. It always has been robbed, and always will be robbed to the end of the chapter.' (Lowe, 1875.)

'We live in an age of wonders, but there is one wonder we have never seen, and that is a Chancellor who will propose a new tax in order to maintain a Sinking Fund.' (Gladstone, 1875.)

A Sinking Fund is 'a sinking fund indeed.' (Gladstone, 1880.)

The Sinking Funds have been suspended, and will be suspended again so surely as anything occurs which strains in the slightest degree the resources of the country.' (Goschen, 1887.)

At other times, when the New Sinking Fund was receiving windfalls, through the maturity of terminable annuities, or the conversion of debt to a lower level of interest, these were not allowed to offset the emergency borrowings from the fund in other years.¹

'It is impossible that Parliament should allow such enormous windfalls to fall into the New Sinking Fund within two years.' It was 'never meant to be more than a small unappropriated balance of the fixed debt charge.' (Hicks Beach, 1899.)

The New Sinking Fund was a sort of plan, but its intended long-period efficacy became the very reason

¹ As in 1860, 1881, 1883, 1889, 1908.

FRUCTIFICATION AND RESERVE

for its short-period depreciation, when the element of capital in the fixed charge became considerable.

The low short-period valuation of the Sinking Fund as a purpose of national finance depends on two considerations; the 'transfer' argument, and the position ascribed to the fundholder.

The Transfer Argument

As regards the transfer argument. Two distinctions are usually made. The first is between the external and the internal debt. The burden of taxation is in both cases the same; for the taxpayer does not look beyond the government which taxes him; and his reactions are the same whatever the final destination of the funds. If we say, with the Colwyn Committee, that the burden of the internal debt is the transfer of the interest, we mean that it is the tax, and this is the same for the external debt. This is one sense of a real burden. In another sense of the real burden, as regards the application of the tax, the fact that money or money's worth goes abroad in one case, and not in the other, is not the criterion. Foreign borrowing is a normal operation and creates no real burden if the loans are productive. The real burden, in this respect, is due to the nature of war expenditure, not to the origin of the loan. It is in so far as the loan has not caused any assets to come into existence, but has been used to create supplies which

THE TRANSFER ARGUMENT

have been entirely destroyed, that the repayments to abroad must come out of the produce of home resources and encroach on the standard of living. But this difference, again, cannot be determined without reference to the meaning of real assets. Immaterial assets may be real, and foreign loans may have been of critical importance in the success of a war. But such immaterial assets as our prestige or security cannot be enjoyed by foreigners or exported to them. It depends, therefore, on what they are worth to us in terms of what can be exported. To the extent that such an estimate can be made, we return simply to the tax burden, and the real burden of that has not been increased by foreign borrowing. It is evident that war must be considered as a normal event in the long-time history of nations, and its success as a part of the true criterion of its whole burden. The Colwyn Committee says that 'the loss to the nation was due to the expenditure' on a war, but this was the cost. Loss depends on the results of expenditure, and there is much public and private expenditure for the sake of results as immaterial as prestige or national status.

It is of course obvious that, if we isolate the fact of repayment, an external debt is always more burdensome than an internal one. It would be better, when a war is over, and the results are what they are, if we had got these results without borrowing abroad. Then the burden of the foreign debt would have

FRUCTIFICATION AND RESERVE

been due to unwise finance, and to the use of some home resources in maintaining 'business as usual' where consumption should have been restricted.

In regard to the internal debt, the economic argument moved away from the special objections which Hume, Adam Smith, and Ricardo made to the funding system, and the transfer argument became more prominent. Adam Smith had said that this argument was 'founded in the sophistries of the mercantile system,' by which I suppose him to mean that it looked only at the monetary aspect of the case. That payments on account of the internal debt are a real cost of some result includes more of the facts than the argument of the two pockets or, in Coleridge's famous reply to Hume, of the husband playing cards with his wife; the latter argument being later described as 'necessarily emanating from a poet'.

There must, in the economy of nations as of great businesses, be transactions which are not in respect of current services, but where the services are rendered at one time, and are settled for over a period of time. This is the nature of loan transactions. The service having been once rendered, it cannot be undone, and so the payments for it, if isolated, can be regarded at a later time as mere transfers in the whole economy. This is not a good line of analysis, because although a particular series of transfers is in respect of a past service, these transfers are

THE TRANSFER ARGUMENT

also the cost of maintaining loan transactions as a whole; they are the consideration, not for past loans only, but for new ones. The burden on the taxpayer is not so idle as to be a mere transfer. Payment for current services enables these services to be continued and, if lending is regarded as a whole, the difference is only one of degree of continuity in the sacrifices made.

The monetary transfer from the taxpayer to the fundholder does not destroy purchasing power, as the Colwyn Committee points out, but what internal tax does? If money is transferred to the State for purposes of public expenditure, the transfer has not destroyed purchasing power, but has only redirected it. The expenditure of the money, on the other hand, will 'use up resources', whether it is the State or the fundholder who spends it. It is equally 'exhaustive' in the end. If we look only at the State as the spending agent, it is true that loan taxation is not spent by it exhaustively, as other taxation is, but then the whole process, from the national point of view, has not been completed. The taxpayer may regard loan taxation as the more onerous, because its final expenditure is for the benefit of the fundholder only, and not for the creation of public services.

From the theory of income, in which debts are disregarded, to the theory of taxation is not quite a

FRUCTIFICATION AND RESERVE

simple step, and this becomes plainer now that the debt has reached such large figures as to account for over one-fifth of taxation. The instinct of the early writers was against a strict parallel in this respect between a nation and an individual. This has been to some extent justified by the incidence of prices on the system. The real burden is held to be increased if prices fall, although what the taxpayer loses by this is gained by the fundholder. If it is only a question of transfer from one pocket to another, it does not matter what the value of money is. There can then be no felt sacrifice, but the burden of taxation is just the felt sacrifice and its reactions. It is an essential fact that the tax has to be exacted, and the worst taxes in the system, as Mill said, may be occasioned by the transfer.

When the whole process of lending, use, and debt charge are considered, internal taxation for the debt cannot be far separated from any other taxation. Money is not borrowed except for a purpose, and some results, however immaterial, must be supposed to exist. The interval in time between the original sacrifice of a loan and the interest payments does not affect the general position. It is when we isolate the payments from the rest of the whole process that we get in this case the argument of mere monetary transfer. In a closed economy, taxation is the direct real burden which is carried by the community for

THE TRANSFER ARGUMENT

obtaining or having obtained some sacrifices and results. The more immaterial these results are, the more does taxation encroach on the material standard of living.

This becomes plain when what has been called the 'indirect' real burden of the debt is considered. It is said to depend on the distribution of wealth, and the incidence of the necessary taxation on rich and poor. Here the word 'real' is being used in its proper sense, as the sacrifice of the taxpayer. On the transfer argument, an indirect real burden ought to mean an indirect loss of resources to the community.

In the case of an internal loan, the transfer is less than the tax, because the fundholder is taxed. The burden of the tax, however, is its full amount, because the fundholder has to pay for his share of the results. If his tax is deducted from his interest, part of the original sacrifice is repaid in kind, in an immaterial form. When a long time has elapsed since the original loan, this sacrifice may be regarded as obliterated, and the debt charge is the cost of public credit, that is, of obtaining new loans.

Although the debt charge, especially on its capital side as the Sinking Fund, has had a low short-period esteem, the Chancellors have been inconsistent in that practically all of them, before and after the War, have accepted the 'burden on posterity' argument.

FRUCTIFICATION AND RESERVE

Posterity both holds and pays the mortgage, and a former generation cannot, in Hume's phrase, 'draw bills' on a later one. But if a generation has inherited a burden, it can hand one on. The question is, therefore, how far a war can be said, without metaphor, to have been 'paid for' by the efforts and sacrifices of the generation which 'waged' it by these efforts and sacrifices. If, for whatever reason, it was necessary to pay home lenders in order to obtain some of these sacrifices, and to pay their successors in order to obtain similar sacrifices in future, is the payment for public credit on any different footing from that which continues any other services in the nation?

Other short-period aspects of debt repayment will be considered later. The influence of the transfer argument caused the very efficacy of the New Sinking Fund of Northcote to be a reason for borrowing it. Though the increase of the capital element in such funds is foreseen and intended, it comes to be set against the tax it requires, and 'too much' is said to be applied to a non-contractual payment of mere internal debt.

The Fundholder

The second reason is the attitude toward the fundholder. Gladstone said that his was the one really idle kind of income. But at that time joint stock companies of the modern sort had scarcely come

THE FUNDHOLDER

into existence. The nature of the private fundholder is still, however, the ground of certain views about the debt charge. That charge is regarded as a transfer less than neutral, and as having definite economic reactions, on the ground that it goes mainly from the industrious part of the nation to the idle, or from the young to the old. Again, the origin of fundholding was in a time of national emergency, from which that amount of capital seems to have made an escape. As the fundholder represents that amount of capital, and his claim represents the degree to which the war was not 'paid for', he is taken as the person who has not paid for it.

Ricardo said that he 'was willing to make a sacrifice and give up as large a share of his property as any other individual. By such means ought the evil of the National Debt to be met.' The failure of so complex a proposal as a levy on capital after a war seems to reflect on the finance which has let the fundholder off. This creates a moral argument on emergency finance. Professor Pigou has put the point in this form, that in such an emergency as war, when everything may be at stake, the principle of the distribution of the burden is that individuals should give, not their shares, but their utmost. The same idea was implied in pre-war argument about the income tax; because of its supposed inequities, it was to be reserved for the emergency of war, when

FRUCTIFICATION AND RESERVE

strict equities mattered less. Or again, after the Great War, when the casualty lists could be appreciated, the idea of a 'conscription of wealth' was set against the war-time 'conscription of life'. Fundholders bear the onus of this argument although, among wealthy persons, they are those who lent money to the government.

There is no clear distinction, as a matter of persons, between those who give other services in a war and those who lend money to the State, and the argument, therefore, simply implies a degree of progression of war-time taxation which would clear all the expenses. But if we provisionally make such a distinction, I cannot feel that just any rate of progressive taxation was the fair offset to the burden of other war services. An emergency has degrees, and a nation would be at its 'utmost' if the troops were unpaid, and other services were rendered at the minimum real wage to the limit of physical power. Short of this, I think that equity enters into the distribution of war costs. It is arguable whether Germany acted more fairly than we did.

The conscription of life in war is in fact a conscription of some personal services, but no one is asked for his life, although the life-risks of some services are greatly increased. The extreme sacrifice has to be kept out of the argument.

The Colwyn Committee was content to say on this

THE FUNDHOLDER

point that 'personal service during the war was rendered in many ways', and I am not sure if a comparison between the services of money and of effort can be made within the same kind.

The other aspects of the fundholder's position are less important, such as the alleged transfer from the industrious to the idle. There must then have been a previous transfer the other way, even if this idea is valid. The fundholder is in fact a very mixed personality, and his idleness may only be a way of saying that he is owed his claim. Capitalists who did not lend to the State in war cannot shift this kind of objection to those who did, and there are now other kinds of income equally idle. Socialist argument is a different thing, but the status of the debt charge among the purposes of public outlay is quite independent of these afterthoughts.

After a war, the distribution of the funds ceases to have any relation to the due contribution of individuals to the public loans. It depends on past sales and purchases of the funds, and exchanges into other securities. It is obvious that the taxable position of an individual for one purpose cannot then be separated from his tax liability for all purposes. If he then receives more in dividends on public securities than the proportion of his taxation which is due to the debt, this does not make his position invidious. I cannot accept the argument of Dr. Dalton on this

FRUCTIFICATION AND RESERVE

point. The position seems to me to be this. If every one had subscribed to War Loan exactly in proportion to his fair taxable liability, his dividends would have cancelled his taxes on this account. Everybody would have been 'representative' of the general conditions. He would, in effect, have paid for his own defence. He ought not to escape that amount of taxation by transferring his security, with its tax liability, to some one else, and using the money otherwise. Now the position is just the same if the debt, instead of being subsequently exchanged, was taken up from the first in amounts not proportional to taxable liability.

The amount of money which the debt represents has as a whole to carry this liability to taxation, because the purpose of its original expenditure was the defence of the whole country, including the subscribers. It is against economic principle to exempt public loans from taxation, as if the subscribers had not themselves benefited by the expenditure. All public services are rendered by a group who thereby assist themselves, each other, and the rest of the community. Their incomes from these services are therefore brought into the general charge, and the rate of taxation all over is the ratio of the public expenditure to the income, not of the private part of the community, but of the whole community. The early economists were confused on this point when they

THE FUNDHOLDER

spoke of taxes as paid by the productive to the unproductive part of the nation.

'It is indispensable', said McCulloch, 'in attempting to form anything like a fair estimate of the national burdens, to deduct from their apparent amount all that portion of the taxes which is paid by public functionaries, and by those subsisting on the dividends or interest of money lent to the government. The burden of taxation remaining after this sum is deducted forms the burden really borne by the public'.¹

But the public includes these functionaries and fundholders, and part of the transfer takes place within the mixed group which they form, since the Civil Service, the military services, the Judiciary, and the rentiers all benefit each other, as well as themselves and the private community. In respect particularly of the fundholders, this was clearly stated by Pitt in expounding his Act of 1798; and the attempt to go back on it was argued on Althorp's proposal in 1831 to place a duty on transfers of property, including the funds. Neither any special tax nor special exemption was defensible; since, in Pitt's words, 'the protection yielded to the fundholder is the same as to the landlord, the merchant, and the manufacturer'.

The short-period low esteem of the Sinking Fund is the impatience of taxation in order to pay off the fundholder. It has indeed been argued by Professor

¹ *Taxation and Funding*, p. 390.

FRUCTIFICATION AND RESERVE

Seligman that, while the tax is a burden on the taxpayer, it is no advantage to the fundholder, because he receives the money but loses his capital. Now, if that were correct, it would also mean that it was no sacrifice to the fundholder to subscribe to the loan originally; because he gave up his money but received his 'capital'. This is an impossible argument. The fundholder receives the tax-payers' money, the scrip being nothing but a document, which might have been just as well a book entry against the taxpayer as one in favour of the fundholder.

However, the fundholder stands for a bad memory, a doubtful asset, and a heavy tax liability. If to all this is added that he is on the richer side of the nation, his claims seem to represent, for short periods, a doubtful fructification of money. The debt comes to be played about with, and the money applied to other purposes.

Short-period Policy

The history of finance shows a gradation of short-period views and policies, ranging from a casual attitude towards the Sinking Fund to more deliberate policies of using it as an instrument for controlling the trade cycle, and ending finally in that reversal of all authoritative pre-war ideas which imply what is called deficiency finance.

The casual attitude was that adopted towards the

SHORT-PERIOD POLICY

Old Sinking Fund. The debt was not budgeted for at all. But it was expected that it would get windfalls in times of good trade. Gladstone stated Peel's principles as follows: to balance income and expenditure in each year, to estimate revenue moderately and expenditure fully, to give away a surplus, when he had one, by reductions of taxation. Under the influence of 'fructification', Chancellors would congratulate themselves and the Treasury officials if there were a very close balance on the Budget, exactly fulfilling the estimates; but, under the influence of long views of the debt, they congratulated themselves also when they had good surpluses. When the New Sinking Fund came into being, the giving away of surpluses meant the giving away of hidden surpluses, for the surplus was in the fixed charge, and was given away by reducing the charge. Even if, in the latter case, the motive was to save the income tax, fundamentally the idea was the same, that the debt was for short periods a use of money of secondary importance.

Next, there are the more purposive ideas. 'It is better', said Snowden, 'in time of depression to use resources to stimulate trade than to make undue sacrifices for the reduction of debt. It is in times of prosperity and abounding revenue and Budget surpluses that we can afford to lessen the intolerable burden of debt.' And so Chamberlain two years later: 'In times of unemployment and stress and trade depression, we

FRUCTIFICATION AND RESERVE

can use our money more wisely and more profitably than in the reduction of debt, provided we make generous provision for it when good times come.' This was called, before the War, the 'denaturing' of the emergency which justified suspension of the Sinking Fund, and the extension of it from war to other kinds of stress. It has two forms: the adjustment of the debt charge to the trade cycle, and deficiency finance. In the former case, it is not a question of allowing a budgetary deficit, but of the use of public finance in the right, but always solvent, manner; in the latter, it is a stronger proposal. They are both plans; but a Chancellor who now announces a financial plan may be assumed to be about to propose an unbalanced Budget.

The Trade-cycle Aspect

Theories of the trade cycle ought to be consistent with its long duration through more than 200 years of economic change. It was very explicitly remarked on by Defoe, and it appears in parliamentary discussion at a time when more than three-quarters of the people of this country were agriculturists, and there was not the difference which now exists between the consuming and the constructional occupations. Nor was there then a degree of intercommunication in the national economy which would explain the cycle by the psychological infection on enterprise. Nor could

THE TRADE-CYCLE ASPECT

wages be said to stand at the figures which represented the marginal productivity of labour, in which case they had room to vary without necessary effects on employment. If the influence of the seasons on harvests is the one long-period cause which remains, then, since in earlier times it would directly affect a much larger part of our labour than in later times, we should expect to find the cycle diminishing in intensity as time went on. This is not proved. It may be that capitalism introduced new elements of instability, so that no single long-period cause can be ascribed.

As a matter of public observation, Pitt referred in 1792 to the 'fluctuations which often happen in the affairs of a great nation, and which it is impossible to calculate or foresee', and other early references may be discovered; the following statement in the twenties may be quoted.

'Trade and manufacture were recovering from the late great depression: according to all past experience, we are now justified in looking forward to a great improvement. The extreme state of distress would, according to what had often before happened, be followed by a gradual advance toward extreme prosperity.' (Parnell, 1827.)

'All countries were subject to alternations of prosperity and depression, which no power could ward off. It seemed to be a rule in the affairs of mankind that blessings should not be showered down without a corresponding visitation of depression.'

FRUCTIFICATION AND RESERVE

This was the Calvinistic theory of Goulburn (1829). And so Huskisson:

'The slightest historical investigation would satisfy any person that trade had always been subject to fluctuations. It had always been found that there were periods when production surpassed consumption, and which were followed by periods of stagnation. As long as prices were falling, persons looked for a still further fall; they would undertake nothing which they could avoid, but directly prices began to rise, then all the speculators rushed into the market.' (1829.)

Peel observed how 'at all periods of our commercial history, there have been these alternations of prosperity and depression', and how 'writers of great authority' had perceived the cycles of 'favourable and unfavourable seasons'. 'A year of abundance does not follow a year of scarcity, but you will have five or six years of the one followed by five or six years of the other.' (1842.)

The aspect of public finance which came to be related to this consciousness of fluctuations was the debt question. It was argued with some confusion. After Peel's attack on Poulett Thompson, deficiency ceased to be defended, but good times enabled the country to bear an otiose excess of taxation for the repayment of debt. But the Chancellors then tended to go farther, and to suggest that these surpluses had actually a fructifying effect. When asked why, on his argument that the debt meant no burden, it should

THE TRADE-CYCLE ASPECT

be reduced, Gladstone was at first content to answer 'why not?' and to appeal to historical practice.

'It may be enough for the present purpose to stand upon this basis, that the reduction of debt has been recognized in this country as a principle of public policy ever since our debt began. A principle so established has something to say for it, even independently of the abstract argument.'

But he went on:

'What becomes of the money? It is not sent to the moon. It is not exported from the country. It finds its way into the money market of London, and that is the point whence loanable capital finds its way to the most direct and profitable employment, in cheapening production and stimulating industry. There is no surer way of promoting an immediate and profitable application of capital than by reducing debt.'

In the same sense, Mr. Baldwin argued in 1923 that 'money devoted to the reduction of debt returns at once to the investment market'. Now, if these arguments are good, a time of prosperity is not the best time to repay debt; or the argument has been imperfectly stated. A second phase of it was that the repayments tended to put up the price of Consols, and so to reduce the rate of interest and make trade more active; as was argued by Asquith and Snowden. This is what we want to do, not in good times, but in bad times.

In order to suit any policy of adjusting public

FRUCTIFICATION AND RESERVE

finance to general conditions, the Sinking Fund should act as a damper on enterprise. This is what has been more recently argued. The proposals for large annual Sinking Funds which were made to the Colwyn Committee, and put into force for a short time, were therefore unscientific, so long as there was any question of a short-period use of the Sinking Fund in relation to the trade cycle. And both history and instinct are emphatic that emergencies imply the suspension or reduction of Sinking Funds.

If the argument is not one *de minimis*—that is to say, if the amount of taxation that is due to the Sinking Fund is considerable¹—the interaction is of this kind. The fundholder is a voluntary seller, whether he sells to the government or to a private buyer. In the latter case, every £100 paid by the buyer goes entirely to the fundholder, who will invest and spend it in some proportion; we do not need to know what the proportion is. If it is the government that is buying Consols out of taxation, the fundholder has to provide part of the tax himself, and there is transferred to him less than £100. He will both spend and invest less. The whole result will tend to lessen incomes and activity, since, although the rest of the community pays the fundholder less than if the transaction had been a private one, it is now a tax, not a

¹ In 1867 Disraeli said it 'might be compared to the incision of the most troublesome, but not really the most unpopular of insects'.

THE TRADE-CYCLE ASPECT

purchase, and is restrictive of enterprise. In the process of public payment, a security is cancelled, and to that extent investors have to look out more than before for private, as distinct from gilt-edged investments. But that favourable reaction is small, since the Sinking Fund is so much larger a proportion of taxation than of the amount of outstanding debt. Even if a considerable amount of Consols is locked up in the portfolios of banks and institutions and is not available, it is also true that the taxpayers whose savings mainly affect enterprise are only a part of the taxpayers and bear this charge in a special degree. Therefore, a substantial Sinking Fund paid out of taxation is a check on enterprise, and a non-contractual Sinking Fund may be used as a regulator of the trade cycle.

Planned Finance

Then there are two stages, planned finance and deficiency finance. The former rested on the strict orthodoxy of Gladstone's maxim that the annual charge must be met every year in a single Budget. It has not been regarded as a breach of this principle to bring certain windfall assets into the revenue, or to forestall certain revenues, as Gladstone did in 1860, and others have done since. The production of such hidden reserves, and the financial manœuvres which are possible in the complicated accounts of a nation,

FRUCTIFICATION AND RESERVE

led to an interesting and acrimonious debate between Harcourt and Goschen in 1891, the question being how far the public accounts could be regarded as intelligible, and whether a Chancellor who had shown a succession of surpluses ever really had one. But it may be said that, up to the War, only a slight degree of planning existed, in the borrowing of the New Sinking Fund, and the expectation that the Old Sinking Fund would automatically vary with the state of trade. Peel's finance in 1842 was a long-period plan, in which the chance of deficit was hedged by the income tax; the plan of getting on without the income tax was definite until the eighties, and continued with lessening conviction till the present century, till as late as 1907 Mr. Asquith thought it worth while to say that that tax 'must now be accepted as an integral part of our financial system'. Gladstone had a seven-year plan in 1853, but in 1860 returned to the limiting case of one-year planning. 'Our plan abandons all attempts to make a financial settlement for a term of years, a method which we do not think suited to the existing state of affairs.' In 1907 Mr. Asquith argued that each year's Budget should be treated as 'an integral part and a necessary link in a connected and coherent chain of policy'. After the War, Mr. Churchill returned to the maxim that 'our accounts are annual accounts', and the more fully planned Sinking Funds were abandoned.

Deficiency Finance

The stronger form of financial adjustment for short periods is deficiency finance. It was out of the argument on this question that, as has been said, the ideas of fructification arose. Up to the War, deficiency budgeting was not so much a plan as a result supported by afterthoughts: since the War, it has become more purposive, but it goes back to the original ideas of how money can best fructify. The principle that the Budget should balance every year has come to be described as 'mouldy'.

In 1827 Canning defended a prospective deficit, and took a vote of Credit, on the ground that returning prosperity might come to the assistance of the revenue; but he, as well as Goulburn in 1828, was in fact defending the sanctity of a fixed Sinking Fund, and there was no real deficit. In the years just preceding Peel's reforms the Chancellors were no longer defending a Sinking Fund, and refused to meet what they hoped would be passing deficits by imposing new taxation. In 1848 Wood had to abandon his proposal of a shilling income-tax, and to draw on the Exchequer balance; 'we must look, not to making the income of the year equal the expenditure, but to keeping our taxation at such a point as to keep the income one year with another equal to the expenditure'. Lewis in 1856 refused to add to taxation to

FRUCTIFICATION AND RESERVE

meet a large expected deficit, on the ground of a 'state of transition' from war to peace finance. The *locus classicus* of such argument was in the heated debate of 1879, when Gladstone denounced Northcote's excuses and pronounced the principle of the control of the House over a single Budget which must balance. You must not budget for a deficit even in bad times; you must meet all charges fully in such times, and use the surpluses of good times for remission of taxation; you must estimate expenditure at an outside figure, and revenue moderately. To this criticism Northcote's reply was vigorous. 'I hold that you ought to make your taxation as little fluctuating as you possibly can; that you ought not to be in a hurry when you get an accidental surplus, to give it away; and that when you have an accidental deficit, you ought not to be in a hurry to put on taxation.' But the orthodox view prevailed in pre-war finance. Disraeli denounced Lewis's proposals: 'This is the first time—I will not say I have heard a deficit recommended and sanctioned by the government, for unfortunately I have heard that—but certainly that I have heard propounded from the Treasury bench a plan which seems to threaten to throw the land into financial confusion.' Northcote himself had said in 1875 that 'if the Chancellor makes proposals which do not present a clear surplus of income over expenditure for the coming year, he is guilty of a default of

DEFICIENCY FINANCE

duty'. 'I am not prepared', said Goschen, 'to say that it is right for a Chancellor to treat it practically as a toss-up whether he will have a deficit or a surplus. He must make sure, so far as human expectation goes, that he is on the right side'. Disraeli attacked Gladstone's Budget of 1860 because the expected surplus was too small to allow for contingencies.

After the War, the original idea that low taxes would 'fructify in the pockets of the people', and restore the revenue, so as to justify deficiency budgeting for a time, appeared in public discussion in an important form. The suggestion was that the income tax should be substantially reduced below its rate of five shillings in order to revive enterprise. Mr. Chamberlain, in the Budget for 1933, referred to this proposal for 'deliberately unbalancing the Budget in order to take a substantial slice off the Income Tax', which was being argued by 'eminent economists, powerful journalists, and some members of the House'. He did not object to this because it was merely unorthodox; but because it was impossible to predict that the loss would be made good; because there would be no real stimulus to trade if it were known that it was being obtained in this way; because an extension of the plan might be demanded if the results did not materialize quickly; and because it might start a race between nations in unbalanced

FRUCTIFICATION AND RESERVE

finance. And these reasons are an echo of Peel's reply to the original proposals of Sydenham:

'The principles were more alarming than even the deficiency itself. The Secretary to the Treasury declared that, even if he could have foreseen this deficiency, he would have felt satisfied that a reduction of taxes ought to have been made. The doctrine that a tax ought to be repealed because it would be a relief to the people, without reference to the obligations for the fulfilment of which that tax was a security, was a most dangerous doctrine for a government to act on or avow. The strongest apprehension that he had entertained from the infusion of democratic power into the House was, that the House would hereafter find it very difficult to resist proposals for immediate relief at the expense of good faith and of the true permanent interests of the country.'¹

Thus, considered as a method of relief to trade, according to the attempted doctrine of fructification, short-period deficiency finance may be said to be marked as unsound; between Mr. Micawber at one time, when he held that the marginal sixpence should be on the right side, and the same authority at another time, when he hoped something would turn up, public finance has decided that he was at his best in the former case. It is possible, however, to conjecture that the smoothing of the trade cycle by deficiency

¹ Cf. Chancellor Spring-Rice, 1837, on the policy of speculating in future revenue by risking present deficits.

DEFICIENCY FINANCE

finance will be a more possible policy the more continuous is the political character of the government, and that it may have a future in autocratic countries, because the government can then take drastic measures to square the account later with less regard for the objections of special interests. In a democratic State a ten-year debt plan is liable to fail, because the fundholders' interests are not held in the same esteem throughout. Old and new principles would be reconciled if it became a convention of sound finance always to budget for a minimum surplus, as Parnell proposed long ago, absolute or relative, such as the produce of a penny of income tax, and to pay over only the realized surplus. This would have defeated the objection to New Sinking Funds of the Northcote type, which were sometimes raided just because the debt element in the annual charge meant an increasing rate of income tax.

Types of Deficiency Finance

The chief types of deficiency finance may here be set in order. They divide broadly into those schemes in which the immediate expenditure is provided for somehow, and those in which it is not. The provision is that of definite sources of revenue. First, the expenditure is provided for by the attachment of particular capital assets, such as windfalls, nest-eggs,

FRUCTIFICATION AND RESERVE

or surpluses like that of the Road Fund a few years ago or the Old Sinking Fund at present; or by borrowing on the future, as when Gladstone anticipated part of the malt duties by shortening credits, or as the three-quarters' payment of income tax was held to have done. Second, expenditure is provided for by raiding a Sinking Fund of the 'new' type, even if, or just because, it is doing what it is there to do. Third, expenditure is provided for by specific borrowing, as in the case of the present armaments loan; this may be regarded as war, though not war-time, finance. Fourth, expenditure is not provided for, except by regarding statutory Sinking Funds as surplus on revenue account. Fifth, expenditure is simply not provided for; this was the Northcote proposal of 1879, on the ground that certain war expenditure was uncertain, anticipated by Spring-Rice in 1839, because the cost of postage reductions was 'a matter of conjecture'; and it was the proposal rejected by Chamberlain in 1933. This non-provision is planless, either in order to keep existing taxation uniform, or by general reliance on recovery of the finances. Lastly, planned budgeting, or the allowing of deficit in a scheme for its certain replacement. The whole question between the orthodoxy of annual accounts, and the 'mouldiness' of such finance, depends on the possibility of such schemes in a democratic state, and with an uncertain course of trade.

Loan Depression Finance

The deficiency finance which was argued in these different phases is a different thing from the use of loan finance in times of depression, although this is sometimes called deficiency finance. It is in fact an aspect of the adjustment of expenditure to policy. Southey made the proposal in 1812 in as definite a form as it has ever had since. Speaking of 'seasons of pressure', he said:

'No time can be so proper for national works, for making new naval stations and improving the old, for cutting roads, draining fens, and recovering tracts of country from the sea. . . . Let it not be said that such (roads) are not necessary, because they have not hitherto been thought so. . . . The object is neither useless nor unimportant . . . but better is it to engage in works of ostentatious convenience . . . better would it be for the State to build pyramids in honour of our Nelsons and Wellingtons, or towers of Babel for star-gazing, than that men who have hands, and are willing to work, should hunger for want of employment.'¹

It was nearly 100 years later that this came into the field of policy in the Reports of the Poor Law Commissioners of 1909. The growth of public services, central and local, and of an unemployment insurance fund, both created new conditions. As regards the former, the existence in the same market of public

¹ *Essays*, vol. i, p. 144.

FRUCTIFICATION AND RESERVE

and private enterprise does not cause the competition between them for labour and capital to be in any way an exceptional fact, the consequences of which have to be specially traced. The latter meant that the cost of public works was the difference between total cost and the cost of unemployed pay. As this difference is less in a depression than in an active period, it was a natural and obvious proposal that such public works as were movable in time should be carried out in times of bad trade. The idea that this obvious policy was a kind of deficiency finance arose out of an ambiguity in the phrase 'relief work'. If public works are shifted in time in this way, the motive is the relief of unemployment; that is the motive *of the shifting*, but not of the works themselves. No long-period policy has ever been adopted which would make this distinction clear, so that shifting takes the form of anticipations of public works when depression has already occurred, and this has cast suspicion on the real value of the proposals, unless they are of a military kind.

But the scope may be limited for the use of such measures of shiftable public works. It may therefore become necessary to raise loans for what are called relief works. This is a phrase which requires a better consideration than it has usually received. Works of this kind have now a bad name, partly because of their history, partly because of a prejudice

LOAN DEPRESSION FINANCE

against simply 'making work'. It is not to be supposed that the reference will always be to forms of road work or spade work. And, in a complex society, work is itself an object of search and desire; it may satisfy more urgent and important desires than some of its products do. Apart from the deprivation of the desire for work, the consciousness of a large degree of unemployment is a 'dissatisfaction' to the community. In other words, employment is itself one of the things that industry is 'for'.

In the ordinary state of industry there are many products for which there is little to be said except that they create work. There is most to be said for them if they are regarded as normal relief work. In technical terms, their market value is not the same as their social value. This is a distinction which may be made in two ways. In its minor form, it means that there are some kinds of production which have incidentally increased the cost at which other products can be obtained. In this sense, as Professor Pigou has pointed out, the product of a brewery should have its market value debited with the effects of its smoke upon, for instance, laundries. But the major form of the distinction would draw attention to the whole output of what may be called 'bad utilities', which are all the same counted at market value in the national product. In this sense, a temperance advocate would take a more extensive view of

FRUCTIFICATION AND RESERVE

the difference between the private and the social values of the products of a brewery. For the sake of the work they give, we afford the frivolous and the deleterious occupations, and it is not unorthodox, if the need arises, to place the making of work high in relation to market values of other products. This is at present the case with munitions industries, whose products will, it is hoped, never be put to their technical use at all. We have always afforded to make large supplies of such things, and keep them till they became obsolete.

Even if we look to final satisfactions, special policies for making work are good, but on other grounds also Southey anticipated the tendencies of modern analysis in the conditions of industrial complexity. This is not only because of the 'multiplier' through which made work reacts on other work, or the saving on unemployment funds. It is also because the activity that results helps to reduce costs, especially overhead costs, in respect of other products. If there is an advantage in running full, there is some loss which may be incurred to obtain it. This is well known to 'dumpers', who have been willing to 'slaughter' large parts of their output in order to have the advantage of running at fuller capacity. It may pay a nation to take a hand in this game in its own way.

This does not mean that it is possible to solve the

LOAN DEPRESSION FINANCE

problem of unemployment fully just by giving employment, and by disguising the position by pretended values of the results of such work. If the community were willing and able to make extra efforts in order to bear all the cost of *ad hoc* employment of this kind, and if it could bring itself to derive as much satisfaction from the thought that people were simply employed as it would have derived from the consumption of actual products, then relief work might be devised on a large scale. The limitation is in the fact that this substitution of satisfactions cannot carry us the whole way; it is not strong enough for that, but it has a range of possible application.

Relief work is therefore a phrase which we should endorse, and not one to fight shy of. It should be separated from forms of work which are felt to be undignified; and it will usually have to be disguised. For example, equipment or installations which are not yet legally obsolescent can be expressly renewed, either in public services or by grants or allowances. And borrowing for relief work should rather be referred to our capital account, than regarded as deficiency finance in the usual sense.

The Long-period View: Posterity

The high status of repayment of debt as a long-period policy has depended on two considerations,

FRUCTIFICATION AND RESERVE

namely, our ordinary duty to posterity, and the chances of future emergency.

It was Mill who stated in Parliament in its strongest form the nature of 'that dutiful concern for posterity which has been strong in every nation which ever did anything great'. His reasons were unusual.

'There are many persons', he said, 'who are not unwilling to ask themselves, in the words of the old jest, "why should we sacrifice anything for posterity? What has posterity done for us?" They think that posterity has done nothing for them; but that is a great mistake. Whatever has been done by mankind by the idea of posterity . . . all this we owe to posterity. All this is ours, because those who preceded us have cared and have taken thought for posterity. Not owe anything to posterity! We owe to it Bacon and Newton and Locke and Bentham; aye, and Shakespeare and Milton and Wordsworth.'¹

We are part of the posterity for whom others have worked or cared, so we must work and care for our successors. The instinct was a natural one that financial measures should be adopted as well as other measures on a long view of the national interest, apart altogether from unknown emergencies. Chancellors have continually asserted this ordinary duty, and expressed it in such phrases as that we should avoid unduly 'mortgaging the interest of future

¹ *Debate on the Malt Duties*, 1866.

THE LONG-PERIOD VIEW: POSTERITY

generations' or making the debt burden 'intolerable'. As posterity both holds and pays the mortgage—a word handed down from the time when specific taxes were earmarked for this purpose—Adam Smith's phrase, 'the liberation of the public revenues' was a better definition of this duty to posterity. Both Adam Smith, and Hume in his brilliant *Essay on the Public Credit*, meant to include in this duty our duty to the fundholder, who was not to be 'juggled' out of his interest by changes in the value of money, or by the levies, bankruptcies, or revolutions which might be the result of an intolerable burden. The Colwyn Committee accepted this ordinary duty as 'the general desirability of effecting some reduction in order that the burden on posterity may not be too great'.

I think, however, that the reference to posterity is largely superfluous, and that our ordinary duty to posterity does not differ much from our ordinary reasons for reducing debt. Posterity must be regarded with the ordinary discount on futurity and uncertainty. Every generation is placed between its ancestry and its posterity in these ways. It receives from the past certain conditions of life and industry, among them a condition of finance and financial knowledge. It changes these conditions by its own work and inventiveness, and hands on a generally improved state of knowledge, the results of which are cumulative. Methods of finance are among these

FRUCTIFICATION AND RESERVE

improvements. Fifty years ago, when expenditure was increased on purposes which 'did not fructify to the revenue', it was feared that the financial system could not meet Budgets which had to provide these 'non-economic charges'; but, in face of the then existing belief in its impracticability, graduated taxation was afterwards developed. All such changes are in a sense provided for posterity, but the outlook is that of the generation which makes them in the ordinary course of its work. They are more for posterity than for the present, because posterity is longer than any generation; but posterity will use, discard, and invent in every sphere. On ordinary grounds, what every generation considers is its own questions of development, and in a sense its results are for, but not on account of, posterity. In the absence of future emergencies, we would pay off debt as a matter of policy for the present and a short future, serving 'our day and generation', and put later posterity under ordinary discount. Shakespeare did not write, nor do we educate our children, for posterity. Repayment of the debt is not in an entirely different category from other current expenditures which have a continuing influence.

There were two other aspects of ordinary duty to posterity which were canvassed at the same time as repayment of debt. The using up of irreplaceable resources, and especially of coal, was a problem for

THE LONG-PERIOD VIEW: POSTERITY

which there was no solution by which posterity could be relieved. We had to choose, Jevons said, 'between brief but true greatness and longer continued mediocrity'. This was one of the three great economic prophecies of the nineteenth century which were upset by the incalculability of future change; the other two were the rapid growth of population and the necessary spread of free trade. In the case of irreplaceable resources, Jevons's solution was, not to go slow, but to make the brief period of abundance as fruitful as possible in social welfare and inventive-ness; but these very results came to show that the irreplaceable was not the indispensable or the unsubstitutable. The duty of any generation in this respect is clearly argued in the report of the American National Resources Board; it is, not to use such resources wastefully in unregulated competition, and to give them all the time which nature allows to create the inventions which will help to supersede them. As regards population, the position of the argument has now been reversed. Any generation, if its birth-rate falls, can worsen the conditions for replacement in the future, and recovery can be made very difficult. There is, I think, no reply to this except by continuity of consideration of the question, and that is owed by any generation to posterity in the light of social and material trends. In the case of repayment of debt, especially when that has reached high

FRUCTIFICATION AND RESERVE

figures, any generation is more clearly able, in this case than in the others mentioned, to confer an advantage on posterity, and can afford to do so with some discount on urgency because the future resourcefulness of finance is not entirely dependent on material progress. For example, the taxation of 'increments' is still undeveloped in this country, and the offsetting of fundholders' dividends and taxes may be found capable of manipulation.

If therefore it were only a question of ordinary finance, it is doubtful if the high long-period esteem of repayment of debt could be maintained. In the century between our two great wars it was mainly to the growth of the national income that the mitigation of the money burden was due, and changes in the methods of taxation further reduced the real burden.

It is the war generation itself which is most conscious of the new figures of debt, and after both the great wars strong Sinking Fund policies were adopted, and then given up. Both debt and taxation are likely to be specially burdensome at that time. 'What', asked Mr. Asquith, 'is a war tax? Not a tax put on to last during a war, and to come to an end the moment peace is concluded. It is a tax which is put on to meet the extra burden imposed on the country by waging war; and so long as the extra burden remains, the claim that war tax quâ war tax

THE LONG-PERIOD VIEW: POSTERITY

can be removed is an inadmissible claim.' But this generation has also borne the real burden of the War. It both bears that burden and is sensitive of the cost which the figures of debt represent. It is apt to overcharge itself.

It is difficult to say after what lapse of time posterity ceases to have the direct advantage of the expenditure for which debt was first incurred. Forty years and more after the French War, the financial statements are found to be still harking back to the significance of that expenditure, a fact which we realize when the Great War is still so vivid after twenty years. For how long is a new condition of national security a real invisible asset, and is it an asset of wasting significance? 'If', said Mr. Lowe, 'we can satisfy people that this is the one spot in the world that is safe, and that will in all probability be free from the ravages of war, think how our credit will rise, how the value of our property will increase, what a predominance it gives us over other nations.' 'At its very lowest,' said Mr. Lloyd George, 'immunity from attack has been for generations and still is (1908) a great national asset. It has undoubtedly given us the tranquillity and the security which have enabled us to build up our great national wealth. It is an essential part of that wealth.' If a war generation has incurred great costs in order to create this asset, it may fairly consider that the cost

FRUCTIFICATION AND RESERVE

of large Sinking Funds should not begin to be incurred till the asset has so appreciably fructified by the efforts of posterity as greatly to lessen the then importance of the original sacrifice. Post-war financiers found that they were thinking of posterity in this respect too soon.

If we take, as a unit of time for this purpose, the conventional period which defines a 'generation', we may say that, when the debt stands at more than 3 per cent., repayment is in the interest of each generation for its own sake; when it stands at less than this rate, repayment includes an element of *special* interest for posterity.

Another argument has taken this form, that there is a set-off to a high level of taxation, because it causes those who are in charge of industry to make greater efforts. This cannot be taken to mean that high taxes are good in themselves; but it lessens the objection to maintaining the taxation which the debt causes, on the ground that posterity is likely to become more rich and resourceful. The very high taxation of a war generation is likely to restrict enterprise; as it passes into high taxation, with an increasing income, there may be some beneficial reactions. There have been some extreme statements of this view. Even in time of war, the Sinking Fund or the debt charges have been credited with good reactions. Coleridge went so far as to argue that it was

THE LONG-PERIOD VIEW: POSTERITY

our National Debt which chiefly defeated Napoleon, because of the great efforts to which it led. Adam Smith and McCulloch wrote more moderately to the same effect. Gladstone defended the much-abused Sinking Fund of Pitt, because Pitt wished 'to produce a practical result, and that was to make persons more willing to lend him their money for the purposes of war. Viewing it purely as a subjective operation, I am by no means sure that he did not produce that effect by his Sinking Fund.' The consideration of such subjective influences does no more than lessen the ordinary desires to relieve posterity. How are these influences supposed to work? In war-time, perhaps by causing persons to make extra efforts when they are directly or indirectly in the public service; but in time of peace, how do persons in industry 'do more work', since every one has to conform to the general arrangements of industry? These general arrangements become more dominant the more industry is organized, and the smaller the proportion of producers who work on their own account. It would seem that a doctor cannot work harder than there is sickness, or an industrialist work harder than there are orders coming in. Also, taxes do not fall on companies but on shareholders, who do not take part in current transactions. I think, however, that there are influences in the supposed direction. There are, I suppose, kinds of business

FRUCTIFICATION AND RESERVE

which companies do not ordinarily like, but are still more or less willing to go into; for example, business in certain foreign markets, or business of certain degrees of risk. This is not refused or neglected to the same extent, when it is desired to maintain a tax-free dividend up to a normal level. So far as this is so, there can be a division of actual work between a war generation, which has worked hard in waging war, and posterity, which can work somewhat harder to carry the charges of debt.

Some authorities have therefore held that, if future emergency were not in question, our ordinary duty to posterity in this respect would not come to much. But we have now to consider emergency, and its twin policy of financial reserve.

Emergency and Reserve

Adam Smith's rules of taxation were mainly taxpayers' maxims. Their range was too narrow. In the classical period of British finance, as I have pointed out, the elasticity of the revenue was a fundamental idea. But the doctrine of reserve taxable capacity was still more important. It obstructed the use of the income tax and supported the long view of the Sinking Fund. It played such a large part in cancellarian finance that its scant discussion in the theory of finance was remarkable. At the post-war rates of income tax, this question begins to

EMERGENCY AND RESERVE

claim attention again. The effective average rate of income tax alone is between two and three times the pre-war rate which, because of 'reserve' ideas, was described as dangerous, and the marginal rate has increased much more. In addition, we have no longer a general tariff in reserve, but in practice.

In the history of our public finance, considerations of emergency and of reserve were joined together. The use of the income tax was restricted, in order that it might be capable of increase if war broke out. As is shown by quotations which follow, it was thought that there was a great virtue in this financial reserve. The history of Budgets is permeated by this idea. Objections were made to what was called the 'denaturing' of the idea of emergency, meaning that the income tax should not be too readily used for other urgent purposes than war. The long-period view of the Sinking Fund was the other aspect of reserve. This has survived to the present time, when the argument of reserved *taxation* has become less prominent. 'A large Sinking Fund and a low income tax' had become, for a generation before the Great War, almost the motto of the financial outlook. That war became a test of the principle that taxes could fructify in war by not being used in time of peace. The two cases must be considered separately, because the influence ascribed to the income

FRUCTIFICATION AND RESERVE

tax was simple and direct, while repayment of debt was supposed to release taxation in one way by maintaining it in another.

The history of the income tax is not merely a history, but a study of the question whether, when a form of taxation is found to be powerful, it is possible to separate its current use from a use called its reserve use. Is there such a valid principle of reserve in the sphere of taxation?

The strength of the opinion that there was, may be illustrated by the following quotations.

When Pitt's income tax came to its memorable end, Wilberforce proposed, as the rule of its future use, the maxim, 'let this tax always be wedded to war'.

The statement of this doctrine of policy was made by Parnell:

'In order to carry into effect a plan for avoiding the necessity of having recourse to loans in a war, with any chance of success, some preparation is indispensable while we are in a state of peace. In the first place, a moderate income tax should be imposed as a foundation to raise, in the first year of war, a full year's produce at an increased percentage; for, if no preparation be made, when war shall happen, everything will be in confusion, and all money matters in great embarrassment. There will be no time for deliberation; everything will be done in a hurry; every kind of expedient will be adopted that promises the means of overcoming the difficulty of the moment; and, as the raising of money by loans

EMERGENCY AND RESERVE

will appear to divest the war of its chief privations, this will be, in all probability, the course adopted.'

He therefore proposed 'the imposing of an income tax of $1\frac{1}{2}$ or 2 per cent., *in order that* one of 10 or 12 per cent. may be brought into full operation the moment a war becomes inevitable'.

The subsequent general history was of this kind. The income tax was introduced by Peel in order to create a financial reform which would liberate industry from indirect taxation. It was never made plain whether the intention was to return to a better-arranged system of indirect taxes. Gladstone's plan of 1853 began the substitution of a new direct tax in the Succession Duties, which were accepted as the future offset of income tax. But in 1860, when that plan failed, he insisted on going on with the principle, and reduced indirect taxation further. The recurrent emergency of the trade cycle made it impossible to do without the tax. But by 1874 it appeared to have reached its 'reserve' peace basis. Gladstone preferred its abolition, but came to regard fourpence as a practicable rate in peace-time. But the growth of expenditure in the eighties gradually forced the tax into a permanent position, in spite of the continuance of the reserve idea. We could not do without the money.

The following ideas of the tax were in conflict with each other over the whole period of pre-war

FRUCTIFICATION AND RESERVE

finance—that the income tax, being unjust in its administration, and incapable of being made just, or of being graduated without greater injustice, was to be abolished when possible; that it was a dangerous temptation to unwise expenditure in ordinary times; that it was a reserve against the contingency of war, which implied some organisation for collecting it being kept in being, and in effect some low rate of tax being kept in existence; that it was an emergency tax, not to be lightly used for balancing budgets, and the idea of emergency came to have a number of interpretations, such as depression of trade, high expenditure, or the fear of war; and that it represented the contribution of the rich to the public revenue, so that it should have some relation to indirect taxation, which fell mainly on the poor, a view which gradually moved in the direction of equal amounts of, or equivalent additions to, direct and indirect taxation.

The following are typical statements of the war reserve idea:

‘Is it not of the highest importance that the sovereign of this country should . . . be able to touch at any moment, as it were by a spring, a source of revenue which in an hour of great emergency would yield 20 or 30 millions, a sum equal to that which foreign potentates raise at a ruinous rate of interest?’ (Disraeli, 1858.)

‘There is no fleet and no army which gives England such

EMERGENCY AND RESERVE

power and influence in the councils of Europe as the consciousness that the income tax is in a virgin state.' (Disraeli, 1862.)

'Where for the dignity, honour and safety of the country we are called upon to make great and rapid efforts in the augmentation and extension of our defences, the income tax is beyond all others the regular and legitimate resource to which to resort.' (Gladstone, 1859.)

'Such an engine as the income tax is to a Minister of this country more powerful than any armament that can be devised; more powerful than fleets and armies. It is therefore worse than madness in time of peace to throw the whole weight of our financial system upon it.' (Disraeli, 1861.)

In 1871, when the original budget proposals had to be withdrawn, and an increase of the income tax substituted, Disraeli accepted the income tax, but insisted on its reserve aspect, 'a line of defence scarcely less important than our fleets and armies'. An increase 'ought not to be lightly proposed; ought not to be proposed in order to obtain a casual or a common result; ought not to be the refuge of a distressed and disconcerted minister'.

'I hold that our power of borrowing as much as she requires, and of raising any revenue which may be required, gives more strength to the country than the aggregate amount of our fleets and armies at any given moment.' (Lowe, 1870.)

'The income tax is being used too much as a general emergency tax, when it ought to be a great reserve.' (Goschen, 1889.)

FRUCTIFICATION AND RESERVE

'The income tax has always been considered a tax that might properly be augmented on the occasion of a war, for the obvious reason that it can be dealt with either by way of raising it or by way of lowering it when the war is over, without any material disturbance of trade or commerce . . . which the increase of any other tax must necessarily involve.' (Hicks Beach, 1900.)

'The second of our great financial reserves for time of war', the Sinking Fund being the first. (A. Chamberlain, 1904.)

'Sheet anchor in time of war.' (J. Chamberlain, 1906.)

'I admit the great importance of these great financial reserves . . . the Sinking Fund and the income tax . . . with a low Sinking Fund and a high income tax, you have a poor and small reserve.' (A. Chamberlain, 1908.)

'A war reservoir.' (A. Chamberlain, 1913 and 1914.)

But, while this argument was used both *in terrorem* and *ad hominem* in the party conflicts of finance, broader ideas of emergency were constantly appearing:

'For war or emergency, but a deficit was a dangerous emergency.' (Baring, 1851.)

'In time of war, or even in warlike times, though not time of war.' (Disraeli, 1859.)

'I have never maintained that the income tax ought to be a permanent portion of the revenue of the country. But I have often tried to point out that, when our expenditure passed beyond a certain point, the income tax must become a permanent portion of the revenue. . . . A high income tax

EMERGENCY AND RESERVE

is a source of danger. Nothing but extraordinary expenditure and extraordinary necessity can justify it.' (Gladstone, 1862.)

'A tax useful in point of amount, but held in abeyance, ready for some great emergency, and not to be called upon for trivial occasions.' (Northcote, 1875.)

'The income tax is one of the taxes to which we have recourse upon every emergency, and whenever we can we ought to be able to rely on this great instrument for prompt financial assistance.' (Goschen, 1888.)

'A great reserve, and a tax to which recourse must only be had in any great or sudden emergency.' (Goschen, 1893.)

'A most readily available reserve on which the State can draw in a sudden and unforeseen emergency.' (Asquith, 1906.)

'A tax whose effective continuance involves the annual perpetration of a gross injustice is a tax which ought to be reserved for great and pressing emergencies.' (Asquith, 1907.)

'Should be reserved as an extraordinary resource for great national emergencies, in which the necessity of a large additional revenue over-rules all objections.' (Mill, Bk. 5. 3. 5.)

'The second great reserve in case of emergency. The Sinking Fund is the First.' (Lloyd George, 1909.)

It was to these latter statements that it was replied in 1909 that their effect was 'to denature the argument' of former Chancellors, on the special meaning of the emergency value of the tax, and that the tax was being used so as to 'blunt its edge' by over-use.

It is obviously difficult to maintain that, in a

FRUCTIFICATION AND RESERVE

general system of taxation, any particular tax has the characteristics of an emergency impost. The weakening of the idea of emergency, from war purposes to peace purposes, was a natural result, and more direct challenges were made to the whole principle.

‘Surely,’ said Cobden, ‘it is now time (1853) to be done with such an argument as this. Is there not this answer to it, that other taxes also did their work during the war? The Customs and Excise duties did their work, and it would be just as reasonable to say that we ought to put the “giant” Customs by, and allow him to repose, until another war breaks out. . . . Is there anything worse in the income tax than in the taxes on tea and even wine? The income tax is not more demoralizing than Customs evasion and inspection, or more obstructive to trade.’

In the same debate, in reply to Gladstone’s eulogy of the ‘giant engine’ of war finance, Disraeli pointed out that it had not been such a colossal instrument in a war which had added 240 millions to the debt in ten years, a remark which would have had still greater force after the three years of the Boer War had added some 120 millions. Mr. Lloyd George replied to himself and others when he asked in 1909:

‘Why should this particular tax be taken as a reserve, more than any other tax? If we had not put this twopence on the income tax, we should have had to put it on sugar and tea. You have to raise the money somehow. If any taxes are to be treated as a reserve, I should say the taxes were those

EMERGENCY AND RESERVE

which would press heaviest on the people who can least afford them.'

And, in the same year, Mr. Chiozza Money argued that the financial reserve

'consists in the entire taxable income of the country. The means by which we get at that income merely represents the tapping of the reservoir. It matters not whether you call it income tax, super-tax, or petrol tax.'

This is right, and the isolation of the income tax is to be understood by reference to a long-conventional acceptance of its early unpopularity, as well as to the slow development of its administrative technique. The view that its inherent injustices made it specially a war tax is not very tenable, for there was no reason why war taxes should not be levied as equitably as peace taxes.

Again, while it was true, as Asquith stated, that a war tax is also a post-war tax, it ought also to be a pre-war tax; and what does this come to, as long as war is a permanent element in financial calculation?

'Gentlemen who are anxious to reduce our naval and military expenditure are never tired', said Austen Chamberlain, 'of telling us [as he had done himself] that our financial reserve is as important a factor in our defensive position as either our army or our navy. I think that is a slightly exaggerated way of putting it, because with an efficient army or navy our financial reserves would never have time to come into play.'

FRUCTIFICATION AND RESERVE

'We are going to win the war', he said later, 'by hard fighting and by nothing else. No strengthening of our financial resources will counterbalance weakness in the field.' The first stages of war, which may be critical ones, cannot be financed by 'reserve' methods.

Reserve and Resources: Taxation

The real resources in time of war are the quantity and quality of labour and equipment. It is not possible to store labour, but the organization of industry under modern capitalism creates a large quantity of work, engaged in peace-time production, whose skill is of the kind required for the production of war products. The constructional industries are a general field in which that quality of labour is kept in activity. Although the menace of war is a constant one, and defence implies the very existence of the State, there is a margin of use in time of peace at which these dominant requirements are balanced against the desire for the varied commodities of ordinary life. The current preparation of war equipment is to be distinguished from the reserve, which is a question of the increment that is available in emergency. That depends on labour, which cannot be stored, but only re-directed.

In his *Essay on Commerce* Hume stated this in words which, allowing for the change in conditions, may still be quoted.

RESERVE AND RESOURCES: TAXATION

'The more labour is employed beyond mere necessities, the more powerful is any state; since the persons engaged in that labour may easily be converted to the public service. In a state without manufactures, there may be the same number of hands; but there is not the same quantity of labour, nor of the same kind. All the labour is there bestowed upon necessities, which can admit of little or no abatement. The greater is the quantity of labour of all kinds, the greater quantity may be taken from the heap, without making any sensible alteration in it.'

More recently, it was argued by Baxter that, when the income of a nation is calculated in figures, all the elements in that calculation cannot be given the same weight for all purposes. Some of them account for more permanent conditions of national life than do others. The less permanent can be substituted by other kinds of product, and the feature of national income in war is that necessities have a larger share in it. Calculated in money of the same value, the real income of a nation in time of war usually increases; for, if munitions of war are, as they are taken to be, part of real income in time of peace, they must be not the less so in time of war. The destruction, by war uses, of the special products of war industry is a form of consumption in no way differing from the destruction of other products by their use in ordinary life. In this way, a highly developed national system of consumption has a power of adjustment to changes

FRUCTIFICATION AND RESERVE

of conditions, without loss. Whatever the financial arrangements, the real income of war time is great, and the rate of unemployment low.

The existence of idle capacity in labour, or land, or other equipment, does not create a war reserve. The resources available for emergency are not thereby increased, but are usually diminished. A nation is better prepared for war the more active it normally is, even in the production of less essential goods and services.

The 'state of defence in which we ought always to be found', or which 'ought to exist abstractedly', is not strictly a part of the war reserve, but belongs to the continuous condition of peace. This line is hard to draw, however, when 'warlike conditions' persist.

How does this apply to the financial argument? If it is the real resources which matter at any time, what was the reserve of financial resources which so greatly occupied the thoughts of the Chancellors for so long a time? The existence of merely a prepared machinery of direct taxation, which was Parnell's and Gladstone's theory of the income tax, is a smaller consideration when direct and indirect taxation have both become necessary to peace-time finance.

'The taxing system', said Adams, 'should be so organized as to be capable of rapid and easy expansion in case of an emergency. It is only necessary that the basis of the established system be so broad, and the rates at which it operates

RESERVE AND RESOURCES: TAXATION

so low, that increased revenue will result from increased rates, and that, provided the emergency continues, new taxes *of the old sort* may be brought into operation.'

But what reserve is created by a low income tax in time of peace? What is the 'danger' of a high rate of income tax, such as was spoken of when the pre-war rate was one shilling?

It is obvious, in the first place, that if the whole of the financial system were deliberately readjusted to the conditions of war, no financial reserve would have been created by the peace-time arrangements of taxation. These arrangements would at once become a bygone. If a war required a rate of taxation of five shillings in the pound of the national income, it would require that all the same, whether the pre-war rate had been one shilling or sixpence. The sixpence less would not have created any financial reserve, for the decision as to what public services should be carried on in war would be taken purely in the light of the new conditions. If it seemed right to increase some public services for the 'home front', the fact that they had been on a lower establishment in peace would only be a fact of the past, which would be irrelevant to the war-time administration. Some of the peace-time services might be reduced, and others might be increased, but what they were now fixed at would be entirely a matter of the whole policy of carrying on the war.

FRUCTIFICATION AND RESERVE

There has, however, to be some continuity between peace and war finance, so that some peace-time services have to be carried on, and there is not a complete revision of the whole system. Willingness to bear taxation is largely a relative matter, depending on the amount of change that has to be made. If, to create a reserve, public services during peace have been kept down to a rate of sixpence in the pound, when a shilling would have been otherwise desirable, and the unavoidable war costs mean a rate of four shillings, the 'reserve' plan would increase taxation to ninefold. If peace-time services had been at their optimum of a shilling, the increase would have been to fivefold. And if the peace-time optimum of a shilling had been used, but had been reduced to its minimum of sixpence in war, the increase would have been to fourfold and a half. The hidden reserve of the peace optimum of taxation for the public services appears, on this basis of argument, to be the right thing to consider. It is similar to the hidden reserve of the Sinking Fund. And there are some of the peace services, such as unemployment funds, which give an automatic war reserve.

The absolute rate of war taxation is of course greatest if the peace services have all to be continued, and create no automatic reserve. But then it is likely that they are essential to either the power or the willingness of the people to maintain both the home

RESERVE AND RESOURCES: TAXATION

and the war fronts. The absolute taxable capacity, as compared with the difference between war and peace, may obviously be increased by the economy which results from the public provision of collective services.

As applied to taxation, therefore, I do not think that the reserve argument, which was so persistent an element in our finance, was a good one. Economy in finance means the avoidance of both parsimony and waste, but its merits are independent of the saving up of taxation. The breaking strain of war is on real resources rather than on finance. Reserve was not the right idea. Taxable capacity is a question of the time, more than of the difference between one time and another.

Taxable Capacity

In time of war, the conditions of taxable capacity are a special underlining of these conditions at any time. First, the condition of maintaining a standard of life. This is what Wagner called the *physiological condition*. Second, the condition of the continuance of the revenue. This is the fiscal condition; in Wagner's words, 'comment il pourra atteindre le taux nécessaire, et notamment être assez persistant, c'est-à-dire comment il pourra être constamment répété conformément aux besoins de l'économie financière'. This passes into his third *condition juridique*.

FRUCTIFICATION AND RESERVE

The compulsory element in the levy is related to the degree of consent to the purposes of taxation, which is high in time of war. Fourth, the condition of maintaining the value of the currency. In war, this monetary condition is weakened, since inflation tends to become a resource of taxation. Fifth, the condition of maintaining a proper relation between savings and income; in war, this condition also is weakened.

Reserve, Debt, and Emergency

In the argument concerning the financial reserve, the Sinking Fund was given an even more important place than the income tax. The ordinary duty to relieve posterity from a burden of debt was not regarded as so imperative as the duty to relieve conditions of future emergency. The Sinking Fund was thought to be the first reserve, and this idea was often stated in very strong terms. It was 'the greatest of all national reserves, in time of war a priceless resource, the source from which all these (ships, guns, and men) are provided. You should be in a position to expend at once vast sums for a sudden and vital struggle. The permanent debt provides you with this reserve.' So said Harcourt in 1894, and ten years later Chamberlain: 'Our first reserve, to be jealously preserved for the contingency of war; to have recourse to it recklessly and without imperious necessity in time of peace is to make as direct

RESERVE, DEBT, AND EMERGENCY

an onslaught on our power to wage an effective war as if we were directly to diminish our naval or military preparations.' A few years later, it was described as 'the Ark of the Covenant'. After the war, it was attempted by different plans to bind the country to a definite Sinking Fund policy, and the Colwyn Committee wished this policy to proceed independently of the state of trade.

The nature of the argument has not been quite the same as in the case of the income tax. Mill pointed out that we could not rely on the growth of the national wealth to disburden us of the debt problem, because 'future generations will have their own emergencies too', and because these emergencies, when they arise, quickly swallow up the results of years or even generations of economy. A great deal can be done in a long time, and undone in a short crisis.

The aspects of emergency, on which the special duty to posterity has been based, are three. First, the problem of credit, since the existence of a large debt makes it more difficult to borrow on good terms; second, the problem of taxation, if the charges of a new debt have to be added to those of an old one; third, the problem of cost, as affecting the amount by which both loans and taxes would have to be increased.

The two former of these aspects would not be the critical ones. Most war credit is domestic, and this

FRUCTIFICATION AND RESERVE

is not likely to fail; the alternative would only be more taxation, but the impulse to lend to the nation can usually be relied on. The tax burden can be borne, if the national income has increased. It is the third problem which, as Mill saw, is the vital one. Future generations do not only have their own emergencies, but these become increasingly costly. Chancellors have frequently referred to this aspect of war equipment, even before war has actually broken out. This is partly due to the fact that inventiveness in this sphere has so indefinite a relation to returns; it is purely an exercise in destructive power. The invention of the first Dreadnought, as was pointed out at the time, simply ran us into greater expense, and set up a new standard of naval expenditure. In addition to technical improvement of this kind, new lines of expenditure, such as submarines and air machines, have been devised with the freedom from any relation to returns on cost which characterizes inventions for pure destruction. The inventor can go ahead without the restriction of affordability which limits the scope of an industrial invention. When war breaks out, there are new conditions. The strain which is put on certain fundamental supplies, especially on the materials of the heavy industries, might have been partly offset by general industrial progress in time of peace, but there comes in the fact that the actual conduct of war greatly increases inventiveness in its equipment.

RESERVE, DEBT, AND EMERGENCY

War cannot be rehearsed or fully prepared for. It was the Great War itself which led to the invention of tanks, although this idea might seem now to be in the stride of methods of offence. It also enormously increased the pace of devices for air warfare. The range and weight of artillery went far beyond what had been foreseen. The whole conditions of the service of line communication were transformed. The equipment with which that service began the war had become derisory when the war ended. It took the war itself to show how to cable messages which could not be overheard a mile or two away by the enemy, although this now seems to have been a natural application of electrical knowledge. Added to this pace of invention is the ruthlessness of waste, which is the consequence of the forced movements of men faster than heavy equipment can be made to accompany them. Although, therefore, the income of this country increased sixfold between the French and the Great Wars, the latter multiplied the debt tenfold in four years, and the post-war financial position was relatively the same in 1923 as in 1818.

The emergency or reserve idea of debt repayment had two aspects. In the first place, the annual charge for the Sinking Fund would create an automatic reserve by its suspension, the money being at once available for expenditure: in the second place, the accumulated amount of the repayments over a period

FRUCTIFICATION AND RESERVE

of time would enable that amount to be borrowed without imposing the extra taxation which, if so much debt had not been redeemed, would have been necessary for its annual service. The annual charge before the War was about 7 millions, which was equal to the interest at that time on about 175 millions, which was nearly the amount by which the debt had been reduced in a century, so that the two sides of this policy of reserve had come to almost an equivalence. If an emergency occurs soon, the annual charge counts for more as a reserve than the accumulated repayment, because it stands for its capital amount, while the latter stands only for the interest upon it; and this may be a reason for a rigid policy of annual charge, as the Colwyn Committee proposed.

Mills's statement, that the emergencies of posterity are apt to be expensive in relation to the preparation for them, may be illustrated from figures. At the end of last century the Chancellor argued:

'Some may think our efforts have been wasted, and that we should have done better if we had allowed the money to fructify in the pocket of the taxpayer. That is not my view. By this self-denying course, the Parliament and the people have raised up a reserve of incalculable importance which, if the time of need should come when this country should again have to fight for its life, would enable us, without imposing a single extra penny of taxation, to raise a couple of hundred millions for the defence of the country, and

RESERVE, DEBT, AND EMERGENCY

without imposing an atom more debt than our predecessors bore without a murmur in 1857.'

Immediately after this statement, a small local war, which was not a fight for our life, added to the debt a little more than half the reserves mentioned in this statement. When the Great War had barely begun, the Chancellor made in 1915 the comment that 'all the 107 millions of debt which have been wiped out since 1906 were used up in two months. If the war lasted another year, the deficit of 862 millions would be met by suspension of the Sinking Fund to the extent of some five millions.' When the reserve argument was popular, the idea was that, in Lowe's words, 'the arbitrament of war will in future be sharp and decisive. Wars, instead of being long torments, will be short agonies.'

The cumulative result of a Sinking Fund policy is very liable not to bring a reserve into existence, if the taxation which it has spared has been applied to other purposes, and if these have become, as our social expenditure did become, an element in the structure of national life. It did not then release taxation, and we are left with the relief which can be obtained from the suspension of the Sinking Fund at the outbreak of war. No Sinking Fund seems likely to play a very large part in this respect in future.

We return, then, to the emergency in credit. The magnitude of the debt may effect this, but it is not

FRUCTIFICATION AND RESERVE

likely that domestic credit would fail on this ground in a rich country faced with a vital emergency. The burden of a debt of about 700 millions was thought in 1913 to be serious, but there was no difficulty in obtaining the credit to multiply it tenfold.

Conclusion

This review of the significance of the reserve or emergency doctrine of public finance will seem to result in almost an impasse of argument. To create reserves by keeping income tax low and the Sinking Fund high does not come to much that is defensible in policy. Nations are likely, and are probably wise, to use these resources mainly in the light of what is right and possible as matters of current finance. Posterity may have more costly emergencies, but a larger income; if emergency is supposed to be nearer at hand than we date 'posterity', we can neither keep taxation low nor Sinking Funds high. This is plain at the present time. The unknown nature, duration, or intensity of future war emergencies shroud our duty toward them in semi-darkness, but my view is on the whole that we neither owe nor can afford much toward the emergencies of posterity. Right finance consists far more in applying it than in reserving it. The most important things we can do are, to have right finance, and fill the gaps in fair taxation; and to have a plan of war finance, especially so as to ensure that loans are

CONCLUSION

not resorted to so soon or in such amount that taxation does not rise to its equitable rates.

I am conscious that in these lectures I have ventured on ground where an academic person should walk carefully. But it was the study of a period which seemed to me to show that cancellarian finance was occupied with questions not quite the same as take the first place in theoretical discussions. I cannot help feeling how much both the doctrine of policy and those of fructification and reserve are affected by the place of war and war finance in the discussion. To revert to a word used earlier in these lectures, this is the great surd of financial policy. I may conclude with two quotations which cover much of what has been in question:

'War consisteth not in battle only, or the art of fighting; but in a tract of time, in which the will to contend in battle is sufficiently known. For the nature of foul weather lieth not in a shower or two of rain; but in a disposition thereto of many days together.'¹

So said Thomas Hobbes; but the other side of this continuing and inestimable influence had been earlier observed by Cicero:

'Omnes urbanae res, omnia haec nostra praeclara studia, et haec forensis laus et industria, latent in tutela ac praesidio bellicae virtutis.'²

Thus does national finance reflect the nature of the world we live in.

¹ *Leviathan*, Part I, ch. 13.

² *Pro Murena*, par. 9.

PRINTED IN
GREAT BRITAIN
AT THE
UNIVERSITY PRESS
OXFORD
BY
JOHN JOHNSON
PRINTER
TO THE
UNIVERSITY